Supreme Court, U.S.
FILED

No. 00-634 AUG 9 - 2000

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IN THE

SUPREME COURT OF THE UNITED STATES

JEANNE PIAUBERT, S.A., a corporation; and
FRAGRANCE GROUP, LTD., a corporation;
petitioners,

vs.

RANDY SEFRIOUI, an individual,
respondent.

On Petition For Writ Of Certiorari
To The United States Court of Appeals
For the Ninth Circuit (no. 97-56131)

PETITION FOR WRIT OF CERTIORARI

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PETITION FOR WRIT OF CERTIORARI

QUESTIONS PRESENTED

1. WHETHER THE COURT OF APPEALS' SUA SPONTE CONSIDERATION OF EVIDENTIARY MATERIAL FOR THE FIRST TIME ON APPEAL, AND ITS IMPLICIT HOLDING THAT THE DISTRICT COURT HAD ABUSED ITS DISCRETION IN REFUSING TO CONSIDER THE MATERIAL; WITHOUT THE COURT OF APPEALS GIVING APPELLANT ANY NOTICE OR OPPORTUNITY TO BE HEARD ON EITHER POINT; AND THE COURT OF APPEALS' SUBSEQUENT HOLDING THAT APPELLANTS' COMPLAINT FAILS TO STATE FACTS SUFFICIENT TO CONSTITUTE A CLAIM FOR RELIEF; VIOLATED APPELLANT'S' RIGHT TO FAIR PLAY AND SUBSTANTIAL JUSTICE, AND THEIR RIGHT TO DUE PROCESS UNDER THE FIFTH AMENDMENT TO THE U.S. CONSTITUTION.

2. IF ARGUENDO THE COURT OF APPEALS DID NOT ERR AS DESCRIBED IN QUESTION NO. 1; WHETHER THE COURT OF APPEALS ERRED BY ADOPTING A "PER SE" RULE THAT IF THE INTEREST RATE ON A NOTE IS LESS THAN THE "PRIME RATE" IN EFFECT AT THE TIME, THAT THE NOTE CAN NEVER BE DEEMED TO BE A "SECURITY" UNDER THE SECURITIES EXCHANGE ACT OF 1934, AND MUST NECESSARILY ALWAYS BE CONSIDERED A "COMMERCIAL" NOTE AND NOT AN "INVESTMENT" NOTE; EVEN WHEN, AS IN THE

PRESENT CASE, A RATE BELOW PRIME MEANT IT WAS MORE LIKELY THAT THE NOTE WAS AN INVESTMENT NOTE AND NOT A "COMMERCIAL" NOTE, THE LENDER AGREED TO PROVIDE UP TO $5 MIL. TO THE BORROWER AS START-UP VENTURE CAPITAL, THE NOTE WAS UNSECURED AND UNINSURED, THE NOTE WAS NOT PAYABLE FOR 5 YEARS, AND THE LENDER ALSO OBTAINED A SUBSTANTIAL EQUITY INTEREST IN THE BORROWER SIMULTANEOUSLY WITH THE BORROWER'S MAKING OF THE NOTE.

3. WHETHER THE ONLY FORM OF "PROFIT THAT A NOTE IS EXPECTED TO GENERATE" THAT A COURT MAY CONSIDER IN DECIDING IF A NOTE IS A "SECURITY" UNDER THE SECURITIES EXCHANGE ACT OF 1934, IS THE INTEREST RATE PAYABLE ON THE NOTE; OR WHETHER, INSTEAD, THE COURT SHOULD ALSO CONSIDER EXPECTED CAPITAL APPRECIATION AND PARTICIPATION IN EARNINGS.

LIST OF PARTIES

The caption of this petition already lists all parties to the proceeding. Supreme Court Rule 14(b).

LIST OF CORPORATE PARENTS AND NON-WHOLLY OWNED SUBSIDIARIES

Petitioner/plaintiff Jeanne Piaubert, S.A. is a French corporation which is wholly owned by Jacques Bogart, S.A., a publicly owned French corporation. Jeanne

Piaubert, S.A. does not have any non-wholly owned subsidiaries.

Petitioner/plaintiff Fragrance Group, Ltd. is a New York corporation which is wholly owned by Jacques Bogart, S.A., a publicly owned French corporation. Fragrance Group, Ltd. does not have any non-wholly owned subsidiaries.

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OPINIONS AND ORDERS BELOW

The Court of Appeals' memorandum opinion is not published. However, a reference thereto appears at 208 F.3d 221 (2000). Petitioners are not aware of any existing citation to the Court of Appeals's denial of their petition for rehearing to that court.

The district court's order of dismissal, and the Court of Appeals' memorandum opinion and its order denying the petition for rehearing, appear in the Appendix.

BASIS FOR THIS COURT'S JURISDICTION

The memorandum opinion of the Court of Appeals was filed and entered on 2/17/00. On 2/29/00 petitioners filed a petition for rehearing with the Court of Appeals, which was denied on 5/18/00. This petition for writ of certiorari is being filed within 90 days of 5/18/00. 28 U.S.C. sec. 2101(c); Supreme Court Rule 13(3).

This court has jurisdiction under 28 U.S.C. sec. 1254 and Supreme Court Rule 13.

STATUTES AND REGULATIONS INVOLVED

This case involves the construction of Sec. 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. Sec. 78j), of the definition of the term "security" in 15 U.S.C. Sec. 78c(a)(10), of SEC Rule 10b-5 (17 CFR sec. 240.10b-5). and the application of F.R.Civ.P.12(b)(6); all of which are reproduced in the Appendix.

STATEMENT OF THE CASE

Petitioners/plaintiffs in the within action are Jeanne Piaubert, S.A. ("JPSA"), a French corporation, and Fragrance Group, Ltd. ("FG Limited"), a New York corporation. First Amended Complaint ("FAC"), Appendix ("A") 23, 25. Plaintiff JPSA is the manufacturer and distributor of Jeanne Piaubert Cosmetics. Plaintiffs

sued respondent/defendant, Randy Sefrioui, for securities fraud, under sec. 10(b) of the Securities Exchange Act of 1934 ("the Act") and Rule 10b-5 thereunder.

The district court had federal question jurisdiction under 15 U.S.C. sec. 78aa and 28 U.S.C. sec. 1331, and had diversity jurisdiction under 28 U.S.C. sec. 1332.

On 6/9/97 the district court granted defendant Sefrioui's motion to dismiss under F.R.Civ.P. 12(b)(6). ruling that plaintiffs' FAC failed to state a claim upon which relief could be granted. A 18-21. An order dismissing the entire action without prejudice was entered on 6/16/97. A 22.

Plaintiffs appealed to the United States Court of Appeals for the Ninth Circuit. On 2/17/00 that court issued its memorandum opinion (A 4-16), partially reversing and partially affirming the district court's order.

In their FAC, plaintiffs plead that in 12/93, defendant Sefrioui solicited plaintiffs, and met with Jacques Konckier, plaintiffs' president, to discuss the possibility of the distribution of Jeanne Piaubert Cosmetics in the U.S. Sefrioui suggested to plaintiffs that Sefrioui, along with his associates, the Hollisters, could begin an entirely new retail franchising business in the U.S. for the purpose of selling and distributing Jeanne Piaubert Cosmetic products in the U.S. A 26-27. The products had never before been sold or distributed in the U.S. After a number of further discussions and communications over the ensuing months, an agreement was reached between plaintiffs, and defendant Sefrioui and the Hollisters, for the establishment in the U.S. of a franchising business for Jeanne Piaubert Cosmetics. A 27-30.

Plaintiffs allege that defendant Sefrioui made a number of misrepresentations to them concerning his educational background and employment history; and

concerning the feasibility and achievability of various business plans, projections and forecasts. A 28-30.

Plaintiffs allege that all of these representations were false and/or misleading, and that the true facts were to the contrary. A 36-42, 45. They allege that the representations were made in telephone and mail communications. A 27-28, 38, 41. Plaintiffs allege that they reasonably and actually relied upon the representations and non-disclosures. A 38, 41-42, 44, 47.

Plaintiffs allege that as a result of the representations and omissions, and in furtherance of the agreement for the establishment of the franchise business, a California corporation called Jeanne Piaubert Holdings, Inc. ("Holdings") was formed. 2/3 of the outstanding shares of the common stock of Holdings were issued to JPSA, and 1/3 to Sefrioui and his co-promoters, the Hollisters. A 31. A limited partnership called "Jeanne Piaubert Cosmetics, L.P." ("Limited Partnership") was formed. The general partner of Limited Partnership was a corporation created pursuant to the agreement for the establishment of the cosmetics franchising business, called Jeanne Piaubert Management, Inc. ("Management"). Plaintiff FG Limited acquired a 49.5% limited partnership interest in Limited Partnership. Certain corporations which were wholly owned by Sefrioui and the Hollisters, and of which Sefrioui and the Hollisters were the alter egos, acquired a 49.5% interest in the Limited Partnership. A 31-32.

Plaintiffs allege that in furtherance of the agreement for the establishment of the U.S. franchising business, on 3/20/94 plaintiff JPSA entered into a Loan Agreement with Limited Partnership, under which JPSA transferred $5 mil. to Limited Partnership, and in return received a promissory note ("Note") from Limited Partnership. A 33.

Plaintiffs specifically allege that the Note was not any of the following: i) a note delivered in consumer financing; ii) a note secured by a mortgage on a home; iii) a short-term note secured by a lien on a small business or some of its assets; iv) a note evidencing a "character loan" to a bank customer; v) a short-term note secured by an assignment of accounts receivable; or vi) a note which simply formalized an open-account debt incurred in the ordinary course of business. Plaintiffs also specifically allege that the Note was not collateralized, and was due on 7/1/99; that the purpose of the Limited Partnership providing the Note was to raise money for the general use of the Limited Partnership and/or to finance substantial investments; and that plaintiff JPSA was interested primarily in the profit the Note was expected to generate. A 33.

Plaintiffs further allege that no payments were ever made on the Note, and that the business failed to get off the ground. A 35.

Plaintiffs plead that JPSA acquired "securities" in the form of the Note from Limited Partnership and the stock of Holdings; and that FG Limited acquired a "security" in the form of its limited partnership interest in Limited Partnership. A 37, 41.

Plaintiffs did not attach a copy of any document to their FAC. However, defendant Sefrioui attached copies of various documents, including a purported copy of the Note, as exhibits to his Rule 12(b)(6) motion. A 87 et seq. (Ex. C to motion), A 190 et seq. (Ex. D),[1] A 224 et

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[1] In order to minimize the size of their Appendix, plaintiffs do not include therein defendant's collectively voluminous Exs. A, B, E and F. None of these is referenced in the Court of Appeals' Opinion or in the within petition for writ of certiorari.

seq. (Ex. G). However, defendant made no argument to the district court that the rate of interest, or the fact that payment of principal and interest were deferred, had any bearing on whether the Note was a "security" under the Act, and did not make any argument based on the text of the Note or the other documents. A 53-85. Since, apart from plaintiffs' reference to and description of the various formation documents in their FAC, the actual text of these exhibits and documents were not part of the case, plaintiffs did not address their text in plaintiffs' opposition to defendant's motion. A 230-272. Moreover, the district court expressly ruled that it was disregarding all of these documents and exhibits submitted by defendant, stating that the matter had not been converted into a motion for summary judgment. A 19.

In partially reversing the district court's order of dismissal, the Court of Appeals held that the district court had erred in ruling that the stock of Holdings was not a "security", and in ruling that as a matter of law FG Limited's limited partnership interest was not a "security"; and remanded the matter to the district court. A 8-9.

In its memorandum opinion, the Court of Appeals acknowledged that plaintiffs' FAC pleads the requisite elements for the "Note" to constitute a "security." A 10.[2]

It also acknowledged the obvious fact that the

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[2] In a securities fraud action, a pleading is sufficient under F.R.Civ.P. 9(b) if it identifies the circumstances of the alleged fraud so that the defendant can prepare an adequate answer. This requires allegations of the time, place and nature of the alleged fraudulent activities, as well as an explanation as to what is false or misleading about the statements. The Rule 9(b) standard is met if it is not impossible to understand plaintiff's allegations. Warshaw v. Xoma Corp., 74 F.3d 955, 960 (9th Cir. 1996).

motivation of Limited Partnership in giving ("selling") the $5 mil. 5/20/94 Note was to raise general operating funds for the venture. A 12.

However, in partially affirming the district court's order of dismissal, the Court of Appeals went outside the pleadings, expressly considered the text of the note attached to defendant's motion (A 224-229) that the district court had expressly refused to consider, and ruled as a matter of law that the subject Note was not a "security" under the Act. A 10, 12-13, 16.

In deciding that it would consider the text of the subject Note, the Court of Appeals implicitly held that the district court had abused its discretion in ruling that it would not consider material extrinsic to plaintiffs' pleading, without giving plaintiffs any notice whatsoever that it would consider the correctness of that ruling by the district court, and without giving plaintiffs any opportunity whatsoever to oppose, on the merits, the argument that the Note showed on its face that it could not be a "security" under the Act as a matter of law.

Since the district court had expressly ruled that it was not considering the text of the Note, and since defendant Sefrioui did not file any cross-appeal; in their Appellants' Opening Brief, plaintiffs addressed neither the correctness of the district court's ruling that it would not consider evidence extrinsic to plaintiffs' FAC, nor the issue of whether the text of the Note itself precluded the Note from being a "security." Defendant failed to file an appellee's brief, and therefore he did not argue either of these issues to the Court of Appeals. Since defendant did not file an appellee's brief, plaintiffs did not file a reply brief. Defendant made no appearance at the 1/3/00 oral argument before the Court of Appeals.

However, the Court of Appeals considered the text of

the Note, and held that the Note could not be a "security" under the Act as a matter of law because it provided a rate of interest of 6%, which was less than the 7.25% "prime rate" purportedly in effect at the time; payment of interest and principal were deferred until 7/1/99; and that as a matter of law no reasonable buyer of a note would have been interested primarily in the profits such a note would be expected to generate; and that therefore the Note was "commercial" in nature and not an "investment", and therefore not a "security" under the Act. A 10-13.

ARGUMENT

1. THE COURT OF APPEALS ERRED IN IMPLICITLY HOLDING THAT IT MAY CONSIDER NEW EVIDENCE AND NEW ISSUES SUA SPONTE WITHOUT GIVING THE APPELLANT ANY NOTICE OR OPPORTUNITY TO BE HEARD.

A district court has "complete discretion to determine whether or not to accept any material beyond the pleadings that is offered in conjunction with a Rule 12(b)(6) motion." Isquith v. Middle South Utilities, Inc., 847 F.2d 186, 193 fn.3 (5th Cir. 1988), cert. den. 488 U.S. 926; 5A Wright and Miller, Federal Practice and Procedure, sec. 1366.

This rule is usually stated in the context of the requirement that the court must either reject the outside material, and analyze the pleading under Rule 12(b)(6); or else accept the outside material, but then convert the motion into a summary judgment motion under Rule 56, and give all parties the notice and opportunity to be heard and to submit material as described in Rule 56.

F.R.Civ.P. 12(b)(6); Fonte v. Board of Managers, 848 F.2d 24, 25 (2d Cir. 1988).

However, some cases have developed an additional rule. If the plaintiff's complaint makes reference to a document, if the document is essential or integral to the complaint and the complaint is based thereon, and if there is no disagreement as to the authenticity of the copy of the document which defendant submits with his Rule 12(b)(6) motion, the district court may consider the text of the document in ruling on defendant's Rule 12(b)(6) motion, even if plaintiff did not attach a copy of the document to his complaint or incorporate it therein by reference. I. Meyer Pincus & Assoc. v. Oppenheimer & Co., Inc., 936 F.2d 759, 762 (2d Cir. 1991); Parrino v. FHP, Inc., 146 F.3d 699 (9th Cir. 1998), cert. den. 525 U.S. 1001. However, even then, the Rule 12(b)(6) motion can only be granted where no set of facts consistent with the allegations could be proven which would entitle the plaintiff to relief. Chem-Tek, Inc. v. General Motors Corp., 816 F.Supp. 123, 126 (D.Conn. 1993).

Here, the district court expressly ruled that it was not considering any of the documents and exhibits defendant had attached to his motion, including the Note (which appeared as Ex. G to defendant's motion, A 181-185). In so ruling, the district court exercised its discretion.

Indeed, although defendant submitted to the district court copies of many documents, including the Note, he did not argue that the interest rate therein, or the fact that payment of interest and principal were deferred, had any bearing on whether the Note was a "security" under the Act. See A 63-65.

Plaintiffs appealed from the district court's order dismissing their FAC. However, defendant Sefrioui did not cross-appeal. Therefore, in their Appellants' Opening

Brief, plaintiffs did not brief the text of the Note, or the propriety of the district court's ruling not to consider the text of the Note, since these were not issues in the case. Furthermore, defendant did not submit a respondent's brief, and therefore plaintiffs did not submit a reply brief.

However, in its 2/17/00 opinion herein, the Court of Appeals claimed that the "prime rate" in effect at the relevant time was 7.25%, and observed that the text of the Note provides for a rate of 6%. The court also observed that the text of the Note indicates that payment of interest and principal were deferred until 7/1/99. The court cited Parrino, and held that plaintiffs' FAC fails to state a claim for relief as a matter of law under Rule 12(b)(6). In considering the text of the Note, the Court of Appeals implicitly held that the district court abused its discretion in deciding not to consider it. A 10-13.

The fundamental requirement of due process under the U.S. Constitution is the opportunity to be heard upon such notice and proceedings as are adequate to safeguard the rights for which the constitutional protection is invoked. Anderson National Bank v. Luckett, 321 U.S. 233, 246, 64 S.Ct. 599 (1944); Link v. Wabash Railroad Co., 370 U.S. 626, 632, 82 S.Ct. 1386 (1962).

In virtually every other circuit, if the court of appeals raises an issue sua sponte, it gives the party litigants notice of that fact, and gives the parties an opportunity to submit supplemental briefs on the issue. See, e.g., In re: Extradition of Howard, 996 F.2d 1320, 1325 (1st Cir. 1993); Gardner and Florence Call Cowles Foundation v. Empire, Inc., 754 F.2d 478, 480 (2d Cir. 1985); Speer v. City of Oregon, 847 F.2d 310, 312 (6th Cir. 1988), Motorola, Inc. v. Computer Displays Intern., Inc., 739 F.2d 1149, 1153 (7th Cir. 1984); In re: Bucyrus Grain Co., 905 F.2d 1362, 1365 (10th Cir. 1990); Duke v.

Cleland, 5 F.3d 1399, 1406 (11th Cir. 1993).

Here, however, the Court of Appeals for the Ninth Circuit never gave any advance notice to plaintiffs that it would sua sponte consider the issue of whether or not the district court had abused its discretion in not considering the text of the Note; or the issue of what was the prime interest rate in effect on 5/20/94; or the issue of whether the purported fact that the interest rate on the note was less than the prime interest rate meant that the subject Note could not be a "security" under the Act as a matter of law; or the issue of the impact of the fact that payment of principal and interest were deferred on the question of whether or not the Note was a "security."[3]

By its opinion herein, the Ninth Circuit has established the rule that it will consider issues for the first time on appeal, and will decide them, without giving the party litigants any notice or opportunity to be heard. The Ninth Circuit decided the new issues herein without giving petitioners/plaintiffs any notice that it would consider them, and without giving petitioners/plaintiffs any opportunity to submit supplemental briefing.

Petitioners/plaintiffs therefore submit that they have been denied their rights of fair play and substantial justice, and/or their right to due process under the Fifth Amendment to the U.S. Constitution. They therefore request that this Court grant their petition for writ of certiorari, so that these important issues may be decided.

Plaintiffs' contention that they were denied their rights by the Court of Appeals is supported by established, analogous law concerning the rights that a district court must afford a litigant.

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[3]The Court of Appeals raised these issues for the first time at the 1/3/00 oral argument.

In Stella v. Town of Tewksbury, Mass., 4 F.3d 53, 55-56 (1st Cir. 1993), the parties appeared for trial, but the district court gave 30 minutes notice that it was going to consider granting defendant summary judgment sua sponte. After the argument was held, it rendered summary judgment.

In reversing, the Court of Appeals held that although a district court has the power to trigger a summary judgment on its own initiative, that power is tempered by the need to ensure that the parties are given adequate notice and an opportunity to bring forward their evidence. A court's power to grant summary judgment sua sponte should be used with great circumspection. The procedural requirements for such a motion required by the federal rules are not "mere window dressing." These requirements demand that the parties be made aware of the court's intention to mull such an approach, and that they be afforded the benefit of the minimum 10-day period mandated by Rule 56. However, the district court had completely failed to follow these principles, and its actions constituted "an especially egregious example of a court . . . unfairly sandbagging litigants."

See also Neitzke v. Williams, 490 U.S. 319, 329-330, 109 S.Ct. 1827 (1989)(affirm reversal of district court's sua sponte dismissal of a pro se complaint as frivolous because it failed to state a claim for relief; plaintiff must be given adequate notice and an opportunity to meaningfully respond and oppose the motion); Celotex Corp. v. Catrett, 477 U.S. 317, 326, 106 S.Ct. 2548 (1986) (sua sponte summary judgment is only permissible if opposing party is on notice that she must come forward with all her evidence and argument); English v. Cowell, 10 F.3d 434, 437 (7th Cir. 1993)(if complaint is not totally frivolous, it is mandatory that district court cannot

dismiss complaint or grant summary judgment without first notifying the parties of its intentions, and allowing them to cure the defect in the complaint and/or to respond with written arguments and/or evidence).

Here, the Court of Appeals did not give plaintiffs any notice or opportunity to brief any of the new issues; in the language of Stella, it "unfairly sandbagged" them.[4]

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[4] The error of the Court of Appeals was not "harmless", because plaintiffs did have something substantial to say in opposition. See English v. Cowell, supra, 10 F.3d at 438. First, the district court did not abuse its discretion in not considering the extrinsic material, i.e., the text of the Note. A district court is entitled to a degree of deference (Pierce v. Underwood, 487 U.S. 552, 560-562, 108 S.Ct. 2541 (1988)), and the district court's decision was not clearly erroneous. See Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 399-405, 110 S.Ct. 2447 (1990).

Secondly, as shown below, even if the text were considered, it is clear that the Note could constitute a "security" under the Act.

Thirdly, whether a particular instrument is a "security" under the Act is a question of fact. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351, 64 S.Ct. 120 (1943); Koch v. Hankins, 928 F.2d 1471, 1479-1481 (9th Cir. 1991). If given the opportunity, plaintiffs would have submitted a declaration from Jacques Konckier, JPSA's president and CEO, as to JPSA's "profit motive" in "purchasing" the Note; as well as declarations from a securities and investment expert to the same effect, and stating that in his opinion an objective, rational investor would have had such a motive.

Fourthly, the Court of Appeals took judicial notice that the "prime rate" in effect on 5/20/94 was 7.25%, and acknowledged that plaintiffs' right to request an opportunity to challenge the propriety of the court's taking judicial notice of this purported fact, as well as the substance thereof, citing F.R.E. 201(e). A 11. However, although plaintiffs requested such an opportunity in their petition for rehearing, the court ignored their request. Plaintiffs wanted a chance to challenge the court's figure, and to demonstrate that the relevant figure may have been something

Of course, even in the absence of a cross-appeal, an appellee may urge in support of affirmance of an order any matter appearing in the record, although his argument may involve an attack upon the reasoning of the lower court; but may not attack the decree with a view either to enlarging his own rights thereunder or of lessening the rights of his adversary. This rule also applies when the court raises an issue sua sponte. El Paso Natural Gas Co. v. Neztsosie, ___ U.S. ___, 119 S.Ct. 1430, 1434-1435 (1999).

Here, the argument that the district court erred in refusing to consider extrinsic matter is not merely an

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else in France, where the lender was based, and may have been something else for an international business transaction.

Fifthly, if given the opportunity plaintiffs would have argued the significance of the other documents created at formation of the venture. Many of these were also attached to defendant's Rule 12(b)(6) motion, but the Court of Appeals selectively did not consider them. These included the the Limited Partnership Agreement (A 87-189) and the Shareholders' Agreement (A 190-222), each of which clearly evidences JPSA's "profit" motive in acquiring the Note. In the former, JPSA promised to loan $5 mil. to the venture, Jeanne Piaubert Cosmetics (JPC); and all parties agreed that JPSA would receive a certain equity position (stock) in the venture, as well as the Note. That is, the agreement providing for both the stock and the Note. When considering if JPSA was motivated by the profit the Note would generate, the court should have considered the entirety of the "bundle of rights" JPSA received.

Sixthly, plaintiffs would have argued that starting 7/1/99, the Note bears interest at 11%, well above the court-described purported "prime rate."

attack on the "reasoning" of the district court. Also, since defendant's proffer of the Note was rejected by the district court, the Note does not appear "in the record."

However, in this petition, plaintiffs assume arguendo that under the rule recited in El Paso, the Court of Appeals could have properly considered the issue of the correctness of the district court's ruling disallowing any extrinsic matter, if raised either by defendant Sefrioui, or by the court sua sponte; providing that plaintiffs had been given adequate notice and an opportunity to respond. That is, for one to merely assert that under El Paso the Court of Appeals could have considered the issue is to merely beg the question and assume the conclusion with respect to the issue involved in this petition for writ. That issue is whether plaintiffs were given adequate notice and an opportunity to respond.

2. THE COURT OF APPEALS ERRONEOUSLY ESTABLISHED A "PER SE" RULE CONCERNING THE RATE OF INTEREST AND WHETHER OR NOT A NOTE IS A "SECURITY"; AND ERRONEOUSLY CONSIDERED ONLY THE RATE OF INTEREST IN EVALUATING THE "PROFITS A NOTE IS EXPECTED TO GENERATE"

A. Introduction

Even assuming arguendo that none of the holdings and rulings of the Court of Appeals for the Ninth Circuit described above was erroneous; petitioners/plaintiffs submit that the court's substantive holdings herein on the issue of whether the subject Note is a "security" are highly inconsistent with decisions of other circuits, and of this Court itself. In the alternative, plaintiffs submit that these are important issues of federal law which need to be

addressed, clarified and settled by this Court. Therefore, they respectfully submit that their petition to this Court be granted. Supreme Court Rules 10(a) and 10(c).

B. This Court's Opinion in Reves v. Ernst & Young is the Defining Authority On When A "Note" is a "Security"

In Reves v. Ernst & Young, supra, this Court noted that the fundamental purpose of the Securities Exchange Act of 1934, as well as of the Securities Act of 1933, was to eliminate serious abuses in a largely unregulated securities market. In defining the scope of the market that it wished to regulate, Congress painted with a broad brush, recognizing the virtually limitless scope of human ingenuity, especially in the creation of countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. In these Acts, Congress determined that the best way to achieve its goal of protecting investors was to define "security" in broad and general terms so as to include the many types of instruments that fall within the ordinary concept of a "security", and to encompass virtually any instrument that might be sold as an "investment." 494 U.S. at 60-61. The term "security" is to be construed flexibly, not technically or restrictively. Superintendent of Ins. of State of New York v. Bankers Life and Cas. Co., 404 U.S. 6, 92 S.Ct. 165 (1971). The court must examine the substance or "economic realities" of the transaction, not only the form thereof, in deciding if a "security" is involved. Futura Dev. Corp. v. Centex Corp., 761 F.2d 33, 39 (1st Cir. 1985), cert. den. 474 U.S. 850.

In Reves, this Court observed that the Act specifically recites that "any note" is a "security," and held that there is therefore a presumption that every note is a security. 494 U.S. at 60-61, 65.

The presumption is rebuttable. A note will be deemed not to be a security if it closely resembles any of a family of notes which the courts have held are not securities: a note made in consumer financing, a note secured by a home mortgage, a short-term note secured by a lien on a small business, a note evidencing a "character" loan to a bank customer, short-term notes secured by an assignment of accounts receivable, a note which formalizes an open-account debt incurred in the ordinary course of business (particularly if it is collateralized), and a note evidencing a loan by a commercial bank for current operations. 494 U.S. at 64-65.

Here, the Court of Appeals correctly held that the subject Note did not closely resemble any of the instruments described in the "family" of instruments set forth in Reves. A 12:21-24.

In Reves, the Court stated that if the subject note does not closely resemble any of the instruments described in the "family", the following factors should be considered when deciding if a note should be added to the list of those instruments which are not securities: 1) the motivations that would prompt a reasonable seller and buyer to enter into it; if the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments, and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security"; on the other hand, if the note is exchanged to facilitate the mere purchase and sale of a minor asset or a consumer good, to correct for the seller's cash flow difficulties; or for some other commercial or consumer purpose; the note is less likely to be a "security"; 2) the plan of distribution; 3) the reasonable expectations of the investing public; 4) whether there exists another

regulatory scheme which significantly reduces the risk of the subject instrument. 494 U.S. at 66-67.

In Reves this Court further held that the "investment vs. commercial" test that had been used by some circuits was really the same way of formulating the same general approach as the "family resemblance" test (491 U.S. at 64). In holding that the note in that case was a "security" under the family resemblance test, this Court held that the subject transaction was conceived as an investment in a business enterprise rather than as a purely commercial or consumer transaction. 491 U.S. at 68.

In its opinion, the Court of Appeals expressly stated that it was relying on statements in Reves indicating notes issued in an "investment" context are "securities", and that those issued in a commercial or consumer context are not; and that the result it reached in this case was based upon its analysis under the investment/ commercial dichotomy. A 9:17-2, 24-28; 10:1-4; 13:5-9.

C. The Court of Appeals' Opinion Irrationally Tries to Break Down Reves Factor no. 1 Into Two Factors

In its opinion herein, the Court of Appeals analyzed the subject Note with respect to Reves' factor no. 1. The court acknowledged that the motivation of Limited Partnership, the "seller" of the subject Note, would indicate that the Note is a "security" under the Act, under that factor. A 12:25-27. The court was clearly correct on that point. The entire purpose of the subject Note was to capitalize the brand new venture with the $5 mil. being provided by plaintiffs. The Note proceeds were the only capital that Limited Partnership received to start up.

This is the age of "Internet" and other start-up companies, which are capitalized initially by contributions by the founders, and which perhaps then issue "IPO's" or

"initial public offerings." Providing "venture capital" is the paradigm of today's way of investing. This Court may take judicial notice of these facts. Ohio Bell Tel. Co. v. P.U.C., 301 U.S. 292, 301, 57 S.Ct. 724 (1937). Here, plaintiffs' FAC, and any other facts the Court may consider, indisputably show that the money that plaintiff JPSA was providing, as evidenced by the Note, was venture capital of this type, i.e., an investment of this type. Therefore, the Note is a "security."

The "family resemblance" test of Reves states that notes given to evidence "ongoing business purpose" loans, such as loans to finance accounts receivable, loans to finance inventory purchases, letters of credit, etc., are not "investments", and are therefore not "securities" under the 1934 Act. The proceeds of these loans do not provide venture capital. Therefore, the notes evidencing these loans are not "securities." However, when a note does evidence the furnishing of venture capital, it does satisfy factor no.1 of Reves, does not "closely resemble" the "family of notes" that are not securities, and is a security.

However, in a rather strange twist, the Court of Appeals attempted to compartmentalize and sever the motivation of the "seller" of the Note (Limited Partnership) from the motivation of the "buyer" of the Note (JPSA), and to transform Reves factor no. 1 into two completely separate and distinct factors. It held that "no reasonable buyer" would have loaned money to a start-up venture below the prime interest rate if it was "interested primarily in the profit the 6% note - as opposed to the Limited Partnership itself - would generate." A 12:27 - 13:2. It then held that "therefore" the subject Note was not a "security" under the Act.

Plaintiffs submit that the Court of Appeals' approach is wrong, and conflicts with Reves and other cases.

Plainly, Reves factor no. 1 considers the overall type of transaction involved, and does not permit a court to use a verbal construct in an effort to characterize the type of transaction in two completely separate and opposite ways, depending on whether one is examining the transaction from the standpoint of the maker of the note, or from the standpoint of the lender. The cases uniformly hold that if the loan proceeds are to be used as venture capital for a new business, for the general purposes of the business, that Reves factor no. 1 has been satisfied. See, e.g., Exchange National Bank v. Touche, Ross & Co., 544 F.2d 1126 (2d Cir. 1976), cert. den. 469 U.S. 884 (cited and relied on in Reves;); Diaz Vicente v. Obenauer, 736 F.Supp. 679 (E.D. Va. 1990).

Since the Court of Appeals' opinion herein is in conflict with Reves and with these cases from other circuits, plaintiffs respectfully submit that this Court grant their petition.

D. The Test of Reves is Satisfied if The Note Pays Interest; the "Rate" of Interest is A Completely Neutral Factor

The opinion of the Court of Appeals herein is based almost entirely on its holding that the purported "prime" interest rate at the time the note was made was 7.25%; the subject note bears a rate of 6%; no rational "investor" would ever provide money if he expected to receive a rate less than the existing prime rate; and that "therefore" the subject note was not "investment" in nature, and "therefore" was "commercial" in nature. Thus, the Court of Appeals herein adopted a "per se" rule: if the note in question bears a rate of interest that is below the prime rate, it can never be an "investment", as a matter of law.

It is true that courts utilizing the "investment/ commercial" dichotomy approach have employed an

"either/or" test - the subject note is either 1) an "investment" note, or 2) a "commercial" or "consumer" note. See, e.g., Zabriskie v. Lewis, 507 F.2d 546, 551 (10th Cir. 1974); Futura Dev. Corp. v. Centex Corp., supra, 761 F.2d at 40.

However, the Court of Appeals' argument proves too much.

Plaintiffs request this Court to take judicial notice that a commercial lender, as well as a consumer loan lender, will be certain to insist on a rate higher than the prime rate (unless the borrower is a Fortune 100 company). The whole concept of the "prime rate" exists in the context of business world, where commercial and consumer loans are made. The "prime rate" is a rate that a bank or other commercial lender will charge its best customers, e.g., Fortune 100 companies. Everyone else who obtains a commercial or consumer loan must pay a rate higher than "prime."

Therefore, since no rational lender would make a commercial or consumer loan at a rate of 6%, if the prime rate were 7.25%; the subject note cannot be a commercial or consumer note, as a matter of law. Therefore, it is an investment note, and therefore a "security"!

Alternatively, if the note bears a rate of interest greater than prime, it must be a commercial note, because any rational commercial lender would insist on such a rate; therefore, it cannot be an "investment" note, and therefore not a "security." However, according to the opinion of the Court of Appeals herein, if the note bears a rate of interest below the prime rate, it cannot be an "investment" note, and therefore not a "security." Therefore, whether the note bears a rate of interest greater than prime or below prime, it cannot be an

"investment" note, and therefore cannot be a "security." Therefore, no note can ever be a "security"!

The Court of Appeals' "per se" rule makes no sense.

In C.N.S. Enterprises, Inc. v. G & G Enterprises, Inc., 508 F.2d 1354, 1359 (7th Cir. 1975), cert. den. 423 U.S. 825, the court correctly noted that every lender of money is an investor in a sense, since he places his money at risk in anticipation of a profit in the form of interest. Thus, in this sense, every commercial lender is an investor. The court further noted that in a sense every investor is a "lender" who loans money to a borrower for a price and is expected to return it one day. In Hussinger v. Rockford Bus. Credits, Inc., 745 F.2d 484, 489-490 (7th Cir. 1984) the court held that "a note that bears a fixed rate of interest is as likely to be evidence of a commercial loan as an investment", and that the fact that the note bears a fixed rate of interest is therefore a neutral factor, which militates neither in favor of nor against the proposition that a note is an "investment" and therefore a "security."

As noted in Reves and in many other cases, the very fact that the note generates interest itself demonstrates that the "buyer" of the note has a profit motive. See, e.g., Reves, 494 U.S. at 68 fn.4 ("We emphasize that by "profit" in the context of notes, we mean "a valuable return on an investment," which undoubtedly includes interest."); Hussinger, supra (notes bore interest at a rate of 1% over prime, but the rate was a neutral factor); Stoiber v. SEC, 161 F.3d 745, 750 (D.C. Cir. 1998), cert. den. 119 S.Ct. 1464; Mercer v. Jaffe, Snider, et al., 736 F.Supp. 764, 770 (W.D. Mich. 1990), affd. w/o opinion 933 F.2d 1008, and sub. nom. Schriemer v. Greenburg, 931 F.2d 893 (6th Cir. 1991).

Plaintiffs submit that these cases establish that if the "seller" gives the note to acquire funds with which to

generally capitalize the business, as opposed to obtaining funds for a "commercial" purpose such as short term financing, financing the purchase of a specific item, etc.; and if the "buyer" is to receive interest; that Reves factor no.1 has been satisfied, regardless of the interest rate the note bears. Plaintiffs submit that by adopting its "per se" rule that a note that bears a rate of interest below prime can never be an investment, and therefore can never be a "security", the Court of Appeals herein has set forth a rule which is in flagrant conflict with the rules of law established by this Court and by other circuits.

E. Instead of Weighing the Reves Factors, the Court of Appeals Herein Treats the Purported Failure of a Perceived Sub-Category of One of the Factors as Providing Automatic Disqualification

Cases from other circuits hold that the fact that one of the Reves factors may not be satisfied is not fatal, and that a final decision can only be made upon the balancing of all the factors. See, e.g., Holloway v. Peat, Marwick, Mitchell & Co., 879 F.2d 772, 779 (10th Cir. 1989)(cited with approval in Reves); vac. and remanded, 494 U.S. 1014; reaffirmed, 900 F.2d 1485 (10th Cir. 1990), cert. den. 498 U.S. 958.

Here, however, the Court of Appeals improperly; treated each of the Reves factors, and each theoretical "subdivision" thereof, as a "necessary condition" or element of a claim under the Act. Under its opinion herein, the alleged failure of the facts to satisfy one perceived sub-category of one of the Reves factors necessarily means that the note is not a "security." Nowhere did the Court of Appeals weigh and consider the seller's motivation herein (obtain venture capital) against the purported motive of the "buyer" of the Note,

in light of the presumption that every note is a "security."

Since the Court of Appeals' opinion is in conflict with Reves and with cases from other circuits, plaintiffs respectfully submit that this Court grant their petition.

F. The Holding That Interest Payable on the Note is the Only Kind of "Profit" That the Note May be Expected to Generate, Conflicts with Reves and With Opinions from Other Circuits

Most importantly, in Reves this Court held that profit in the form of interest payable was only one kind of "profit" to be considered in the analysis of factor no. 1. At 494 U.S. at 68 fn 4, this Court explained that by "profit" in the context of notes, the Court meant "'a valuable return on an investment"; that "capital appreciation" and "participation in earnings", by themselves, are "too restrictive" in describing what the Court means by "profit" in this context; and that profit may also "include" the interest on the note itself.

However, plaintiffs submit, by the same token, "profit" in this context may also include "capital appreciation" or "participation in earnings."

Here, it is beyond dispute that plaintiffs' FAC alleges, and that any extrinsic evidence that may be considered demonstrates, that JPSA expected the Note to generate a profit in the form of capital appreciation, participation in earnings, and interest.

However, in its opinion, the Court of Appeals completely ignores the "capital appreciation" and "participation in earnings" aspects of this factor! Instead, the Court of Appeals' opinion states that interest is the only way in which a note may generate "profit" under Reves. Plaintiffs submit that this approach is erroneous, and conflicts with Reves.

Although the Court of Appeals did not consider the

actual text of the Shareholders' Agreement and Limited Partnership Agreement, the Court of Appeals summarized the allegations of the FAC, and stated:

> "On these facts, the only economically sensible explanation of the unfavorable terms of the note is based on the fact that JPSA had a 2/3 interest in the holding company that owned the general partner of the limited partnership from which it bought the note. That newly formed limited partnership needed operating funds, and JPSA supplied those funds when it bought the note. Although JPSA could not reasonably have expected to profit from the below-market interest it earned on the note itself as an investment instrument, it could have hoped to reap its reward from the business profits it expected the limited partnership to generate." (A 12:6-17, emphasis added).

Therefore, the Court of Appeals expressly acknowledged that JPSA did have a profit motive in buying the Note. It erred, however, when it stated that the only kind of "profit" that may be considered in deciding if the Note is a "security" is the rate of interest payable; and that the "profit" the note is expected to generate in the form of enabling the business to get off the ground and function, and of enabling the buyer of the note, who is also the holder of a substantial equity interest in the company, to receive capital appreciation and participation in earnings, may not be considered.

The Court of Appeals artificially "compartmentalized" the transaction, and insisted on considering the Note by itself (A 12:1-5, 12:27 - 13:2), as if JPSA had no other connection to or interest in the venture! However, such a view ignores the "economic realities." It is plain that JPSA supplied the loan proceeds (evidenced by the

Note), and that those loan proceeds were expected to generate a profit.

Even when a lender occupies no other role in a venture, he hopes to make a profit from the fact that the borrower will utilize the loan proceeds to generate business activity and will make a profit thereon, and will use those profits to repay the lender. The "note" is only a piece of paper; it does not "generate" profit. Instead, it is always the loan proceeds which generate the business activity, and which therefore generate the "profit."

Therefore, plaintiffs submit that Reves requires a court to consider whether the lender is motivated by the expectation of profits that the loan proceeds are expected to generate, in every case. The Court of Appeals' distinction between "profits the note is expected to generate" and "profits the loan proceeds are expected to generate" makes no sense.

Before this Court decided Reves, some lower courts had had difficulty in determining that a "note" was a "security" because of confusion about whether or not any instrument, including a note, had to satisfy the "investment contract" elements of SEC v. W.J. Howey Co., 328 U.S. 293, 66 S.Ct. 1100 (1946), including the elements of reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. Reves, 494 U.S. at 64. Under Howey, expectation of business profits and/or capital appreciation were the typical kind of "profits" that an investor who satisfied the Howey elements was seeking.

However, in Reves this Court rejected the notion that a "note" must satisfy all of the Howey elements before it may be considered a "security" (Id.), and instead adopted the "family resemblance" test of the 2d Circuit for a "note to be a "security", as described in cases such as Exchange

National Bank, supra, and as explained hereinabove. While adopting the easier to satisfy "family resemblance" test, the Court also relaxed the test for the element of the kind of profit that the investor should expect. As noted above, the investor is not required to demonstrate that he expected business profits or capital appreciation. Instead, he may satisfy the requirement by simply demonstrating that he expected to receive "profit" in the form of interest on the note.

However, that is not to say that profit in the form of interest on the note is the only way in which the investor may show that he expected some profit. Instead, that is only one way. Plaintiffs submit that such an investor may also show that he expected profit in the form of business profits and/or capital appreciation. Stating it another way, profit in the form of business profits or capital appreciation have not been "ruled out" as ways of showing expectation of profit with respect to a "note."

However, in its opinion herein, the Court of Appeals has ruled out business profits and capital appreciation as ways in which a lender may expect a note to generate profits, holding that in order for a note to be a "security", the only kind of "profit" that is relevant is interest itself.

See also Diaz Vicente v. Obenauer, supra (plaintiffs bought "units" and "participation agreements" in real estate project; principal not to be repaid for 2 1/2 years, and net proceeds from project would also be payable to plaintiffs, so plaintiffs' ultimate return on their cash contributions would be quite high; held that under Reves' "note" analysis, plaintiffs had acquired "securities"; In re: NBW Commercial Paper Lit., 813 F.Supp. 7, 12 (D.D.C. 1992)(bank holding company sold commercial paper to capitalize its wholly owned mortgage subsidiary; the relevant inquiry concerning the motivation of the buyer

of a note is whether he is interested in "profit or investment" (emphasis added), rather than financing appurtenant to a sale); 5 A.Jacobs, Litigation and Practice Under Rule 10b-5 (2d ed.), sec. 38.03[dd][ii][B] (same); Holloway v. Peat, et al., supra, 879 F.2d at 778 (one factor under "commercial/ investment" test for note to be a "security" is whether repayment is contingent on profit or productivity; later opinion, 900 F.2d at 1487-88, holds that the 8 factors for the "commercial investment" test yield same results as the 4 factors of the "family resemblance" test); Shults v. Henderson, 625 F.Supp. 1419 (W.D.N.Y. 1986), aff'd. w/o opinion 805 F.2d 391 (2d Cir. 1986)(HBC corp. sold radio station to D, in exchange for a 10 year promissory note and a 10 year consulting contract for H, the principal of HBC; held that the note was a "security"; the note and consulting agreement put HBC and H in the position of having first rights to the profits in the station for the next 10 years; this was unquestionably a 10 year investment in the hoped-for profitability of the station); National Bank of Commerce v. All American Assur. Co., 583 F.2d 1295 (5th Cir. 1978) ("commercial/investment" test; note was not a "security"; bank anticipated no gain beyond the repayment of the note with interest; repayment was not conditioned on the profit or productivity of the borrower); Westchester Corp. v. Peat, et al., 626 F.2d 1212, 1216 (5th Cir. 1980) ("commercial/ investment" test; note is more likely to be a "security" if lender expects to participate in maker's profits or is to receive substantial benefits from maker's success extrinsic to the direct return on the loan); 5 A.Jacobs, supra, sec. 38.03[dd][ii][B] (same); Futura Dev. Corp. v. Centex Corp., supra, 761 F.2d at 41 (factors for a note to be a "security" under the "commercial/investment" test include

whether the object of the payee of the note was to acquire an interest in the property or enterprise of the borrower, and the degree to which the profit on the note is in the hands of the maker rather than the payee); Zabriskie v. Lewis, supra, 507 F.2d at 551 and fn.9 (one way in which an "investment" transaction involving a note may be distinguished from a "commercial" transaction is that "stock" is oftentimes actually given in the former; also list same factors as in Holloway, supra).

Some of these cases (Holloway, National Bank) hold that if repayment of the principal and/or payment of interest is contingent on the profitability or success of the borrower, it is likely that the note is a "security." Here, no payment of interest or principal was due until more than 5 years after the making of the note. Therefore, as a practical matter, if the new business venture were not successful and profitable, Limited Partnership would no doubt cease doing business and be dissolved long before the passing of 5 years. Therefore, as a practical matter, repayment of principal and payment of interest were contingent on the success or profitability of the borrower. However, the Court of Appeals ignored that fact.

Plaintiffs submit that the opinion herein of the U.S. Court of Appeals for the Ninth Circuit is in direct conflict with this Court's opinion in Reves, and also with the above-cited opinions from other circuits. They respectfully request that their petition be granted.

3. THE FACTS INDICATE THAT THE OTHER REVES FACTORS MAY BE SATISFIED

It is settled that the question of whether a particular instrument is a "security" under the Act is a question of fact for the trier of fact. See, e.g., L&B Hosp. Ventures v. Healthcare International, Inc., 894 F.2d 150 (5th Cir.

1990), rehear. den. 901 F.2d 1110, cert. den. 498 U.S. 815; Koch v. Hankins, 928 F.2d 1471, 1479-81 (9th Cir. 1991). Here, even if arguendo the Court of Appeals properly considered the text of the Note, the facts are clearly sufficient to permit a trier of fact to conclude that the subject Note is a "security" under the Act.

Plaintiffs have already demonstrated this proposition with respect to Reves factor no. 1.

Although there was no distribution of notes to the general public, case authority indicates that Reves factor no. 2 may be satisfied if the "buyer" of the note was not in the business of making loans. Hussinger, supra, 745 F.2d at 488; Zabriskie, supra, 507 F.2d at 551; Movielab, Inc. v. Berkey Photo, Inc., 452 F.2d 662 (2d Cir. 1971). Here, plaintiff JPSA was clearly not "in the business" of making loans. Moreover, a number of cases have found the existence of a "security" where the subject note was distributed to or "purchased" by only one person or entity. See, e.g., Movielab, Inc.; Exchange National Bank v. Touche, Ross, et al., supra; Shults v. Henderson, supra.

Decisions after Reves have held that factor no. 3 ("reasonable expectations of the investing public") is inapplicable when there has been no issuance of securities to the public. (see, e.g., Guidry v. Bank of LaPlace, 740 F.Supp. 1208,1215 (E.D.La.1990), aff'd., mod., 954 F.2d 278 (5th Cir. 1992)). Therefore, that factor is inapplicable here.

Reves factor no. 4 ("whether any other regulatory system applies") is limited to whether any other federal regulatory system applies. Holloway v. Peat, Marwick, et al., supra, 900 F.2d at 1488; 5 A.Jacobs, supra, sec. 38.03[dd][ii][B]. Here, there is no such other federal regulatory system. Other authority indicates that the 4th factor of Reves should be more broadly stated as

inquiring whether any other "risk reducing" factors, such as collateral or insurance, are present. If there are such factors, there is less need for protection under the federal securities laws. See, e.g., Resolution Trust Corp. v. Stone, 998 F.2d 1534, 1539 (10th Cir. 1993); Bradford v. Moench, 809 F.Supp. 1473, 1483 (D.Utah 1992)

Here, the subject Note was uncollateralized and uninsured, and there were no other risk reducing factors.

Furthermore, as noted supra, even if arguendo one of the Reves factors were to imply that the instrument was not a security, that would not be fatal. Instead, a court is to balance and weigh the factors.

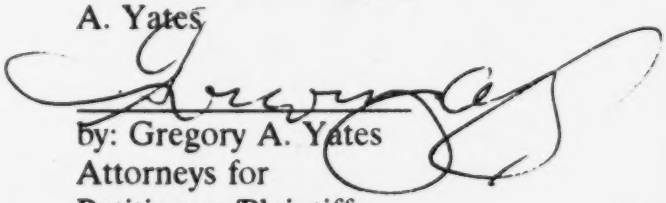
Moreover, anytime a lender gives money and the borrower gives a note, there has been a "sale" of the note within the meaning of the securities laws. Zabriskie v. Lewis, supra, 507 F.2d at 552.

CONCLUSION

For the foregoing reasons, petitioners/plaintiffs, Jeanne Piaubert, S.A., and Fragrance Group, Ltd., respectfully submit that their petition for writ of certiorari be granted.

Dated: Sept. 26, 2000

Respectfully submitted,
Law Offices of Gregory A. Yates



by: Gregory A. Yates
Attorneys for
Petitioners/Plaintiffs,
JEANNE PIAUBERT,
S.A., and FRAGRANCE
GROUP, Ltd.

Supreme Court, U.S.
FILED
(2)

No. 00.634 AUG 9 - 2000

IN THE

OFFICE OF THE CLERK

SUPREME COURT OF THE UNITED STATES

JEANNE PIAUBERT, S.A., a corporation; and
FRAGRANCE GROUP, LTD., a corporation;
petitioners,

vs.

RANDY SEFRIOUI, an individual,
respondent.

On Petition For Writ Of Certiorari
To The United States Court of Appeals
For the Ninth Circuit (no. 97-56131)

APPENDIX TO
PETITION FOR WRIT OF CERTIORARI

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CONTENTS REPRODUCED FROM FURNISHED PRETYPED COPY.

No. ____

IN THE

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JEANNE PIAUBERT, S.A., a corporation; and
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For the Ninth Circuit (no. 97-56131)

APPENDIX TO
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FRAGRANCE GROUP, LTD

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STATUTES, REGULATIONS AND RULES OF COURT INVOLVED

Sec. 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. Sec. 78j) makes it unlawful, inter alia, for anyone

> "to use or employ in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange Commission] may prescribe."

The term "security" is defined in 15 U.S.C. Sec. 78c(a)(10), inter alia, as "any note, stock, certificate of interest or participation in any profit-sharing agreement, . . . investment contract, . . ."

Rule 10b-5, promulgated by the SEC, states:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the

circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. §240.10b-5.

F.R.Civ.P. 12(b)(6) provides:

"Every defense, in law or fact, to a claim for relief in any pleading . . . shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion:

. . .

(6) failure to state a claim upon which relief can be granted."

FILED
NOT FOR PUBLICATION FEB 17 2000
UNITED STATES COURT OF APPEALS
Cathy A. Catterson, Clerk
U.S. Court of Appeals
FOR THE NINTH CIRCUIT

JEANNE PIAUBERT, S.A., a Corporation; FRAGRANCE GROUP, LTD., a Corporation,

Plaintiff-Appellants,

v.

RANDY SEFRIOUI, an Individual,

Defendant-Appellee.

No. 97-56131

D.C. No. CV-97-00327-HLH

MEMORANDUM[1]

Appeal from the United States District Court
for the Central District of California
Harry L. Hupp, District Judge, Presiding

---

[1] This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as may be provided by Ninth Circuit Rule 36-3.

Argued and Submitted January 3, 2000
Pasadena, California

Before: TROTT, FLETCHER, W., Circuit Judges, and MOLLOY, District Judge.[2]

Jeanne Piaubert, S.A. ("JPSA") and Fragrance Group, Ltd. ("FG Limited") (collectively "Appellants") appeal the district court's order dismissing their claims against Randy Sefrioui ("Sefrioui"). Appellants argue with regard to their securities claims that because the complaint sufficiently pled all of the elements of a securities fraud violation, the district court erred in granting Sefrioui's motion to dismiss. In addition, Appellants argue that the district court erred in dismissing their state law claims pursuant to the Colorado River Water Conservation Dist. v. United States, 424 U.S. 800 (1976), abstention doctrine. We have jurisdiction pursuant to 28 U.S.C. § 1291, and we REVERSE and REMAND to the district court.

Because the parties are familiar with the facts of this case, we will not reiterate them here.

DISCUSSION

A. Rule 12(b)(6) Motion

We review de novo a district court's order granting a motion to dismiss for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6). Steckman v.

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[2] The Honorable Donald W. Molloy, United States District Judge for the District of Montana, sitting by designation.

Hart Brewing, Inc., 143 F.3d 1293, 1295 (9th Cir. 1998). Our review under this Rule is generally limited to the contents of the complaint. Warshaw v. Xoma Corp., 74 F.3d 955, 957 (9th Cir. 1996). But where, as here, the complaint

necessarily relies on an underlying document and neither party disputes its authenticity, we may consider it also, regardless of whether it has been attached to the complaint. See Parrino v. FHP, Inc., 146 F.3d 699, 706 (9th Cir. 1998). "We take as true all allegations of material fact stated in the complaint and construe them in the light most favorable to the nonmoving party." Warshaw, 74 F.3d at 957.

Appellants challenge the district court's dismissal of their securities law claims, arguing that their complaint alleged sufficient facts, which, if proven, would establish that Sefrioui violated section 10(b)[3] of the Securities

---

[3]Section 10(b) provides, in relevant part, that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

....

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Exchange Act of 193 4 ("Exchange Act") and Rule 10b-5[4] promulgated thereunder, as well as

section 25401[5] of the California Corporations Code.

---

15 U.S.C.A. § 78j (1997).

[4] Rule 10b-5 provides that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240. 10b-5 (1999).

[5] Section 25401 provides that:

It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

Cal. Corp. Code § 25401 (West 1977).

Specifically, Appellants contend that, contrary to the district court's holding, their complaint adequately pled that a purchase or sale of securities had occurred. Because Appellants, JPSA and FG Limited, claim that they purchased separate securities, we consider each of their arguments in turn.

1. JPSA

JPSA argues that its complaint alleged facts sufficient to establish that it had purchased two separate securities -- the Holdings, Inc. stock and the promissory note. We address each claim in turn.

In Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985), the Supreme Court held that if stock possesses the characteristics usually associated with common stock,[6] then the stock is a security. Id. at 693. Here, JPSA's complaint alleged that the Holdings, Inc. stock is a security because it stated that the stock possessed all of the characteristics usually associated with common stock. Furthermore, JPSA pled sufficient facts to allege that it purchased the Holdings, Inc. stock by stating that it

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[6] The Court identified those characteristics as: "(i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value." Landreth, 471 U.S. at 686.

provided the business venture with $5 million and over $960,000 worth of cosmetics inventory. It is true that the complaint did not allege specifically that JPSA received the Holdings, Inc. stock in exchange for the $5 million and the inventory. For purposes of Rule 12(b)(6), however, we must construe the complaint liberally, see Argabright v. United States, 35 F.3d 472, 476

(9th Cir. 1994), and we must not dismiss the complaint unless it appears beyond a reasonable doubt that JPSA can prove no set of facts in support of its claim that would entitle it to relief. See Johnson v. Knowles, 113 F.3d II 14, 1117 (9th Cir. 1997). We therefore hold that the complaint pled sufficient facts regarding the Holdings, Inc. stock to survive a Rule 12(b)(6) motion to dismiss, and we REVERSE and REMAND this claim to the district court.

The Supreme Court has taken a different approach to the categorization of promissory notes. In Reves v. Ernst & Young, 494 U.S. 56 (1990), the Court explained that only those notes issued in an investment context are securities governed by the securities laws; those notes issued in a consumer or commercial context are not. See id. at 63. To determine whether any given note is a security, courts should apply a "family resemblance" test. Id. at 65. Under that test, a note is presumed to be a security, but that presumption is rebutted if the note resembles a family of notes that are clearly not securities. See id. Moreover, even if the note does not bear resemblance to any note among the list of non-security

notes, a court should continue its analysis and examine four factors that make it more or less likely that a given note was issued as an investment, rather than in a consumer or commercial context. See id. at 66. First, a court must

examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security."

Id. The court should also consider whether there is common trading in the note, the expectations of the investing public as to whether or not such a note is a security, and whether any other regulatory scheme other than securities law reduces the risk associated with the instrument. See id.

In clear reliance on Reves, the complaint before us alleges that "[t]he purpose of the Limited Partnership providing the Note was to raise money for the general use of the Limited Partnership and/or to finance substantial investments, and JPSA was interested primarily in the profits the Note was expected to generate." Nonetheless, the structure of the business dealings alleged in the complaint in combination with the terms of the note itself require us to conclude that the note was issued and purchased for commercial rather than investment purposes.

Appellant JPSA purchased the promissory note for $5,000,000 from Jeanne Piaubert Cosmetics, LP on May 20, 1994. The note was to pay simple, noncompounding interest in the amount of six percent annually, and it was not to

mature until July 1, 1999. JPSA had no right to receive interest payments at all until the note matured. Purchase of such a large note from an untested, high-risk new venture on such unfavorable terms and at such a low rate of return makes no economic sense if JPSA "was interested primarily in the profits the Note was expected to generate." The prime lending rate on May 20, 1994, was 7.25%.[7] See Federal Reserve Statistical Release (visited February 4, 2000) <http://www.bog.frb.fed.us./releases/HI5/data/d/prime.txt> . This is the rate that commercial banks offer to their best commercial customers who have the lowest risk of

---

[7] Pursuant to Federal Rule of Evidence 201, we take judicial notice of the prime lending rate. See Fed. R. Evid. 201(b) ("A judicially noticed fact must be one not subject to reasonable dispute in that it is ... capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned."); see also Mir v. Little Co. of Mary Hosp., 844 F.2d 646, 649 ("In addition to the complaint, it is proper for the district court to take judicial notice of matters of public record outside the pleadings and consider them for purposes of the motion to dismiss.") (internal quotation marks omitted). Although we already have taken judicial notice of this fact, the parties still are entitled to request an opportunity to be heard as to the propriety of taking judicial notice and the tenor of the matter noticed. See Fed. R. Evid.201(e).

defaulting on their loans. If JPSA truly had expected to profit from the note, as it now claims, it would have demanded a much higher rate of return than the prime rate in order to compensate it for the substantial risk of default that an untested business venture necessarily entails.

On these facts, the only economically sensible explanation of the unfavorable terms of the note is based on the fact that JPSA had a 2/3 interest in the holding company that owned the general partner of the limited partnership from which it bought the note. That newly formed limited partnership needed operating funds, and JPSA supplied those funds when it bought the note. Although JPSA could not reasonably have expected to profit from the belowmarket interest it earned on the note itself as an investment instrument, it could have hoped to reap its reward from the business profits it expected the limited partnership to generate.

Applying the Reves test to the facts alleged in the complaint as illuminated by the undisputed terms of the note itself, it is clear that the note is not a security subject to the securities laws. Beginning with the presumption that the note is a security, and finding no resemblance between the note and the list of notes that are clearly not securities, we nonetheless find the presumption rebutted when we apply the four-factor analysis. Although the Limited Partnership, as the seller, may well have intended to raise general operating funds, no reasonable buyer would have been interested primarily in the profit the 6%

note -- as opposed to the Limited Partnership itself -- would generate. Further, there was no public

distribution of the instrument, and the investing public could not have formed expectations that this note would be governed by the securities laws. We conclude that this was a commercial rather than an investment note, and we accordingly AFFIRM the district court's dismissal of JPSA's claim of securities fraud in regard to the note as proper.

2. FG Limited

FG Limited argues that the complaint sufficiently alleged that it had purchased a security, namely the limited partnership interest in JP Limited Partnership. A limited partnership interest is a security if it possesses the essentials of an "investment contract," as the Supreme Court defined that term in SEC v. W.J. Howey Company., 328 U.S. 293 (1946). In Howey, the Court defined an "investment contract" as a contract, transaction, or scheme whereby: (1) a person invests his or her money; (2) in a common enterprise; and (3) is led to expect profits solely from the efforts of others. Id. at 298-99. Furthermore, this court has held that a limited partnership interest generally is a security because "by definition, it involves investment in a common enterprise with profits to come solely from the efforts of others." SEC v. Murphy, 626 F.2d 633, 640-41 (9th Cir. 1980).

In this case, FG Limited alleged that it purchased a 49.5% limited partnership interest in JP Limited Partnership for $5000. Furthermore, FG Limited pled that, as a limited partner, it did not have the ability to control the operations of JP Limited Partnership. Rather, FG Limited alleged, Sefrioui and the Hollisters controlled the day-to-day operations of the limited partnership. Considering these allegations in light of the Howey test, FG Limited has pled facts sufficient to prove that its limited partnership interest is an "investment contract" and, therefore, a security.

The district court in this case, however, held that the limited partnership interest was not a security because the third element of the Howey test was not satisfied. The court explained:

> To be an investment contract, one of the characteristics is that the investor is passive and relies on others to make money (or not). That also is not the situation here,, where plaintiff retained two-thirds of the stock of Holdings, thereby controlling it and its subsidiary, and the limited partnership by the control of the general partner.

In other words, the court held that JPSA controlled the limited partnership because it held the majority interest in Holdings, Inc., which owned Management, Inc., the general partner of JP Limited Partnership. The court reasoned, therefore, that the limited partnership interest was not an "investment contract" because Appellants did

not expect profits solely from the efforts of others.

Although the district court's reasoning may have been sound with respect to JPSA, it was not as to FG Limited. The court apparently treated JPSA and FG Limited as one entity; however, the complaint clearly alleges that they are two separate corporations. Moreover, nothing in the complaint suggests that FG Limited had any interest in either Holdings, Inc. or Management, Inc. Accordingly, we hold that FG Limited pled facts that, if proven, are sufficient to establish that it purchased a security and, therefore, we REVERSE and REMAND this claim to the district court as well.

B. Dismissal of State Law Claims Pursuant to Colorado River

Appellants also argue that the district court erred in dismissing their state law claims for fraud and deceit, negligent misrepresentation, and breach of fiduciary duty pursuant to the Colorado River abstention doctrine. At oral argument, however, we learned that Appellants adjudicated these claims in state court, and obtained a default judgment in their favor. In addition, Appellants informed this court that appellee Sefrioui apparently has absconded to France. We

therefore REMAND to the district court to consider Appellants' state law claims in light of these

developments.[8]

AFFIRMED in part; REVERSED and REMANDED in part.

[8] We also refer Appellants' request to take judicial notice of the state court action to the district court.

NOT FOR PUBLICATION
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

[FILED MAY 18, 2000
CATHY A. CATTERSON,
CLERK U.S. COURT OF
APPEALS]

JEANNE PIAUBERT, S.A., a Corporation; FRAGRANCE GROUP, LTD., a Corporation

Plaintiff-Appellant

v.

RANDY SEFRIOUI, an Individual,

Defendant-Appellee.

No. 97-56131

ORDER

Before: TROTT, FLETCHER, W., Circuit Judges, and MOLLOY.[1]

Appellants' petition for rehearing filed March 1, 2000, is hereby DENIED.

1

---

1 The Honorable Donald W. Molloy, United States District Judge for the District of Montana, sitting by designation.

CENTRAL DISTRICT OF CALIFORNIA
CIVIL MINUTES - GENERAL

Case No. CV 97-0327 HLH (RNBx) Date June 9, 1997

Title Jeanne Piaubert, S.A., et al. v. Randy Sefrioui, et al.

DOCKET ENTRY

PRESENT:

HON. HARRY L. HUPP, JUDGE

Maynor R. Galvez	Cynthia L. Mizell
Deputy Clerk	Court Recorder

ATTORNEYS PRESENT FOR PLAINTIFFS:	ATTORNEYS PRESENT FOR DEFENDANTS:
Gregory A. Yates Peter Dion Kincken P. Sowla	Robert G. Campbell S. Moon

MOTION TO DISMISS
MOTION TO STAY FEDERAL ACTION

PROCEEDINGS:

ORDER (also, if applicable, findings and memorandum opinion):

The FRCP 12 (6) (6) motion to dismiss is granted without leave to amend as to claims 1, 2, and 3 (securities fraud) and denied as to the balance of the complaint. Claims 1, 2, and 3 are dismissed. The court determines to abstain as to the remaining claims under the Colorado River doctrine and dismisses said claims without prejudice to renewal in the Superior Court.

Both parties have improperly attached numerous documents, none of which may be considered on a motion to dismiss. They are disregarded by the court. This matter has not been converted to a summary judgment motion.

The main problem with the First Amended Complaint (FAC) is that it still does not allege that the stock in Holdings was purchased or that it was sold by the defendant. Instead, it alleges that plaintiff and defendant formed a company in which plaintiff was issued two-thirds of the shares, that Holdings formed a wholly owned subsidiary (Management), and that Management was the general partner of the limited partnership. An action for damages for fraud under the securities acts (federal or state) must involve the purchase or sale of stock (or, alternatively, an investment contract). The complaint does not allege that such happened. No purchase by plaintiff is alleged. No sale

by defendant is alleged. To be an investment contract, one of the characteristics is that the investor is passive and relies on others to make money (or not) . That also is not the situation here, where plaintiff retained two-thirds of the stock of Holdings, thereby controlling it and its subsidiary, and the limited partnership by the control of the general partner. Whether or not there was fraud in connection with this transaction, it was not securities fraud.

The two 10(b) (5) claims and the state law securities claims are dismissed without leave to amend.

The court denies the motion to dismiss claims 4 (common law fraud), 5 (negligent misrepresentation), and 6 (breach of fiduciary duty) for failure to state a claim.

The federal claims (1 and 2) having been dismissed, the only basis of federal jurisdiction is diversity, which is present. However, there is an action pending in the Superior Court (in which the defendant here is the plaintiff) in which state law claims are also asserted. While the shape of the pleadings is not identical to this action, it nonetheless appears that the facts in controversy in the state court action are the same facts relevant here. The state court action started before this action. Frankly, it makes no judicial or financial sense to have the state law claims litigated in two fora at once. Further, the state court is a preferred venue for purely state law claims. It is determined that this is a proper case for the application of the Colorado River abstention doctrine. This leads to dismissal of this action without prejudice to renew in Superior Court.

Order dismissing the action without prejudice is signed and filed this date.

A:970327.69

THIS CONSTITUTES NOTICE OF ENTRY
AS REQUIRED BY FRCP, RULE 77(d)

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

JEANNE PIAUBERT, S.A., et al., No. CV97-0327-HLH (RNBx)

Plaintiffs,

v.

ORDER DISMISSING ACTION WITHOUT PREJUDICE

RANDY SEFRIOUI, et al.,

Defendants.

This action is dismissed in its entirety without prejudice.

This Order is a final judgment for purposes of Fed.R.Civ.P. 54(a). It shall be entered pursuant to Fed.R.Civ.P. 58 and 79(a), and served upon the parties.

IT IS SO ORDERED.

Date: June 9, 1997.

/s/ HARRY L. HUPP
United States District Judge

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[FILED
USDC 4/28/97]

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

Jeanne Piaubert, S.A., a Corporation, and Fragrance Group, Ltd., a Corporation,	Case No. CV 97-0327 HLH FIRST AMENDED COMPLAINT FOR:
Plaintiffs,	1. VIOLATION OF §10(B) OF SECURITIES EXCHANGE ACT
vs.	OF 1934 AND RULE 10B-5 2. VIOLATION OF CAL. CORP. SECURITIES
Randy Sefrioui, an Individual, Does 1 Through 20,	LAW §25401 3. FRAUD AND DECEIT 4. NEGLIGENT

Defendants.

MISREPRESENTATION
5. BREACH OF FIDUCIARY DUTY

DEMAND FOR JURY TRIAL

Plaintiffs allege:

JURISDICTION AND VENUE

1. This action arises under section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j), and Rule lOb-5 (17 CFR § 240.10b-5) promulgated thereunder by the Securities Exchange Commission. This court has jurisdiction under 28 U.S.C. § 1331 and Section 27 of the Exchange Act (1 5 U.S.C. section 78aa). This court also has jurisdiction pursuant to 28 U.S.C. §1332 in that the matter in controversy is between citizens of different States and citizens or subjects of a foreign state are additional parties and the amount in controversy exceeds S75,000, exclusive of interest and costs. The court has supplemental or pendent jurisdiction under 28 U.S.C. § 1367(a).

2. The Defendants reside in the Central District of California and have their principal places of business here. Many of the acts and transactions constituting the violations of law complained of occurred in the Central District of California.

PARTES AND OTHER PERSONS AND ENTITIES

3. At all times mentioned herein, Plaintiff Jeanne Piaubert., S.A. ("JPSA") has been a corporation organized under the laws of France, with a principal place of business in France.

4. At all times mentioned herein, Plaintiff Fragrance Group, Ltd. ("FG LTD") has been a corporation organized under the laws of the State of New York, with a principal place of business with a principal place of business in the State of New York.

5. At all times mentioned herein, Jacques Konckier ("Konckier"). an individual, has been the President of Plaintiffs JPSA and FG LTD.

6. At all times mentioned herein, Defendant Randy Sefrioui ("Sefrioui"), an individual, has been a resident of the Central District of the State of California.

7. At all times mentioned herein. Gary Hollister ("G. Hollister"), an individual, and Beverly Hollister ("B. Hollister"), an individual, have been residents of the Central District of the State of California. Gary Hollister and Beverly Hollister are sometimes referred to hereinafter as "the Hollisters."

8. The Defendants designated herein as Does 1 through 20 are presently unknown to Plaintiffs. The true names, identities and capacities, and the respective relationships of the Doe Defendants to the known Defendants are presently unknown to Plaintiffs, who sues

said Doe Defendants by such fictitious names. The Doe Defendants are believed to be individuals or entities who are involved in the acts set forth below, either as independent contractors, suppliers, agents, servants or employees of the known Defendants, or through entering into a conspiracy and agreement with the known Defendants to perform these acts, for financial gain and profit, in violation of Plaintiffs' rights. Plaintiffs will request leave of Court to amend this Complaint to set forth

their true names, identities and capacities upon ascertaining the same. The Doe Defendants and the known Defendants are referred to hereinafter collectively as Defendants.

9. Except as otherwise alleged herein, each of the Defendants have been or are the principals, officers, directors, managing agents, agents, employees, representatives, and/or co-conspirators of each of the other Defendants and in such capacity or capacities participated in the acts or conduct alleged herein and incurred liability therefor. Each of the Defendants made the misrepresentations, acts, omissions and non-disclosures alleged hereinafter with the knowledge, consent, authorization, ratification and approval of each other Defendant.

10. In or about December 1993, as a result of Sefrioui's solicitation of Plaintiffs, Sefrioui met with Konckier at Plaintiffs' office in Paris, France, for the purpose

of discussing the possibility of the distribution of Jeanne Piaubert Cosmetics in the United States through the United States based company that Sefrioui was then representing. Following this meeting, Sefrioui told Plaintiffs that, in his opinion, Jeanne Piaubert Cosmetics products were much higher in quality than he had expected and were far too expensive to be distributed through the company Sefrioui was then representing. Sefrioui suggested to Plaintiffs that Sefrioui, along with Sefrioui's associates, G. Hollister, who Sefrioui represented was the former president of the largest cosmetic franchising company in the United States, Merle Norman Cosmetics, and B. Hollister, who Sefrioui represented was a former high ranking officer of Merle Norman Cosmetics, could begin an entirely new retail franchising business in the United States for the sole purpose of selling and distributing Jeanne Piaubert Cosmetics products in the United States.

11. Plaintiffs were interested in Sefrioui's suggestion, and Konckier met with Sefrioui, G. Hollister and B. Hollister on two or three occasions in or about January through March 1994 at Plaintiffs' office in Paris, France. During these meetings and in telephonic and mail communications between Defendants and the Hollisters and Plaintiffs during the period of January through May 1994(the "Communications"), Sefrioui and the Hollisters made several representations to Plaintiffs regarding their background, experience, prior business responsibilities, professional accomplishments, and forecasts concerning the number of stores the could and would open in the

first year of operation of a new United States franchising business for Jeanne Piaubert Cosmetics. Sefrioui and the Hollisters made these representations in an effort to persuade Plaintiffs to join with Sefrioui and the Hollisters in creating a new retail franchise business in the United States that Sefrioui and the Hollisters would operate for the sole purpose of selling and distributing Jeanne Piaubert Cosmetics products and to persuade and induce Plaintiffs to enter into the agreements and transactions described below.

12. During the Communications, Sefrioui, on his own behalf and on behalf of the Hollisters and Defendant Hollisters/Sefrioui Group, made many representations to Plaintiffs concerning his background. Sefrioui sent Plaintiffs a copy of his resume prior to March 17, 1994 and represented that the statements made therein were true. Sefrioui made representations orally and in his resume that Sefrioui had a certain educational background, including, but not limited to, a masters degree, that Sefrioui had held several high ranking positions with reputable companies in the financial community, domestically and internationally, that Sefrioui had operated as a partner with financial strategic alliance groups, that Sefrioui had had a great deal of experience with the prominent consulting firm of McKinsey & Co., that he had regularly and successfully handled the financial restructuring of Fortune 500 companies who were in financial difficultly, that he had implemented plans he had drafted for such tasks, and that he was familiar with drafting business plans with respect to retail operations and

successfully implementing them.

13. During the Communications, Sefrioui, G. Hollister and B. Hollister made many representations to Plaintiffs regarding G. Hollister's and B. Hollister's experience and background in the retail cosmetic franchising business in the United States, including but not limited to representations that G. Hollister was the former president of the Merle Norman Cosmetics franchising business, that G. Hollister had been responsible for running the company, that B. Hollister had been a high ranking officer in the Merle Norman Cosmetics franchising business and possessed expertise in the marketing of cosmetics in the United States, and that Merle Norman Cosmetics was the largest and only cosmetics franchising business in the United States. Plaintiffs are informed and believe, and thereon allege, that the Hollisters had been terminated from their

positions with Merle Norman Cosmetics as the result of alleged improprieties by them. Neither the Hollisters nor Sefrioui disclosed these facts to Plaintiffs.

14. During the Communications, both Sefrioui and the Hollisters represented to Plaintiffs that G. Hollister had been responsible for opening the great majority of the 3,500 Merle Norman Cosmetics franchises in the United States, that G. Hollister had been responsible for opening at least 300 Merle Norman franchise stores in one year, that the Merle Norman Cosmetics franchising business was going to

close down in the near future, that large numbers of the former Merle Norman franchise owners with whom he had relationships would then become purchasers of Jeanne Piaubert Cosmetic franchises, and that G. Hollister would be able to bring in $50 million per year in annual revenue from the Merle Norman franchise store owners to the new United States franchising business for Jeanne Piaubert Cosmetics.

15. In or about March or April 1994, Seffioui and the Hollisters prepared and submitted to Plaintiffs a business plan ("Business Plan"). In this Business Plan, Sefrioui and the Hollisters represented that, based upon their business experience and under their operation and direction, they would be able to open 120 franchised stores in the first year of business of the new prospective United States franchising business for Jeanne Piaubert Cosmetics. In the Business Plan, Sefrioui and the Hollisters represented that Sefrioui and the Hollisters could and would successfully achieve the opening of 120 stores in the first year of operation and would generate significant projected revenues during the first couple of years of operation, including the first year, that such projections and/or forecasts were realistic, reachable, achievable and doable, that in the United States that many stores were normally opened in a start-up retail franchising business in the first year of business, especially since the, United States franchising business for Jeanne Piaubert Cosmetics would be only the second cosmetics franchising business in the United States, and that Sefrioui and the Hollisters would work in a competent and diligent manner.

Plaintiffs' Acquisition of "Securities" as a Result of

Defendants' Misrepresentations and Omissions

16. On or about April 15, 1994, in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States franchising business for

Jeanne Piaubert Cosmetics, and as a result of the representations, omissions and non-disclosures of Sefrioui and the Hollisters as alleged above, a California corporation named Jeanne Piaubert Holdings, Inc. ("Holdings") was formed. Two-thirds of the outstanding shares of the common stock of Holdings were issued to Plaintiff JPSA, and one-third of the outstanding shares of the common stock of Holdings were issued to Sefrioui and the Hollisters. These shares of stock bore the usual characteristics of "stock" as that term is commonly understood in that the holder of the stock (i) had the right to receive dividends contingent upon an apportionment of profits; (ii) the stock was transferable; (iii) the stock could be pledged or hypothecated; (lv) the stock conferred voting rights in proportion to the number of shares owned, and (iv) the stock had a capacity to appreciate in value.

17. On or about April 15, 1994, in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States franchising business for Jeanne Piaubert Cosmetics, and as a result of the representations, omissions and non-

disclosures of Sefrioui and the Hollisters as alleged above, a limited partnership called "Jeanne Piaubert Cosmetics LP" ("Limited Partnership") was formed. The general partner of the Limited Partnership was a corporation called Jeanne Piaubert Management, Inc. ("Management"). Plaintiff FG Limited acquired a 49.5% limited partnership interest in the Limited Partnership. Certain corporations which were wholly owned by Sefrioui and the Hollisters. and of which Sefrioui and the Hollisters were the alter egos, acquired a 49.5% interest in the Limited Partnership. Plaintiff FG Limited invested almost $5,000 for its limited partnership interest in the Limited Partnership. Plaintiff-FG Limited's investment was an Investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others, *i.e.*, Sefrioui and the Hollisters. These efforts were the undeniably significant ones, *i.e.*, those essential managerial efforts which affected the failure or success of the enterprise. Under California law and under the terms of the limited partnership agreement, Plaintiff as a limited partner, did not have the ability to control the operations of the limited partnership. The Defendants and the Hollisters controlled the day to day operations of the limited partnership. In addition, the Hollisters possessed unique entrepreneurial and/or managerial skills and abilities in connection with the operation of the franchising business and Plaintiff was so dependent on the unique entrepreneurial and/or managerial ability of the

otherwise exercise meaningful control over the Hollisters that it could not replace the Hollisters or otherwise exercise meaningful control over the Limited Partnership.

18. On or about March 20, 1994, in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States franchising business for Jeanne Piaubert Cosmetics, and as a result of the representations, omissions and non-disclosures of Sefiioui and the Hollisters as alleged above, Plaintiff JPSA entered into a Loan Agreement with the Limited Partnership, pursuant to which Plaintiff JPSA transferred $5 million to the Limited Partnership and in return received a promissory note ("Note") from the Limited Partnership. The Note was not any of the following: (1) a note delivered in consumer financing; (ii) a note secured by a mortgage on a home; (iii) a short-term note secured by a lien on a small business or some of its assets; (iv) a note evidencing a "character" loan to a bank customer; (v) a short-term note secured by an assignment of accounts receivable; or (vi) a note which simply formalized an open-account debt incurred in the ordinary course of business. The Note was not collateralized and was due on July 1, 1999. The purpose of the Limited Partnership providing the Note was to raise money for the general use of the Limited Partnership and/or to finance substantial investments, and JPSA was interested primarily in the profit the Note was expected to generate.

19. On or about May 20, 1994, in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States

franchising business for Jeanne Piaubert Cosmetics, and as a result of the representations, omissions and non-disclosures of Sefrioui and the Hollisters as alleged above, Management entered into employment contracts with Sefrioui, G. Hollister and B. Hollister. Each employment contract was for a period of five years, provided for a salary of $250,000 per year, and provided that the employee could not be fired except for cause. Under Ss's employment agreement, Ss was made the Vice Chairman and Chief Operating Officer of Management and the Limited Partnership. Under G. Hollister's employment agreement, G. Hollister was made the Chief Executive Officer of Management and the Limited Partnership Under B. Hollister's employment agreement, B. Hollister was made the Chairman and President of Management and the Limited Partnership. Sefrioui, G. Hollister and B. Hollister controlled the day to day operations of the Limited Partnership.

20. On or about May 11, 1994, in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States franchising business for Jeanne Piaubert Cosmetics, and as a result of the representations, omissions and non-disclosures of Sefrioui and the Hollisters as alleged above, JPSA caused $120,000 in initial start-up funding for the new business venture to be sent to a bank account in the United States that Sefrioui and the Hollisters controlled and from which they were able to make withdrawals. Plaintiff's funding continued throughout the remainder of 1994 and totaled $980,000 by

the end of that year.

21. As of July 1996, in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States franchising business for Jeanne Piaubert Cosmetics, and as a result of the representations, omissions and non-disclosures of Sefrioui and the Hollisters as alleged above, Plaintiffs had provided funding of over $5 million pursuant to the agreement for the establishment of the United States franchising business for Jeanne Piaubert Cosmetics. By July 1996, Plaintiffs had also provided to the United States entities over $961.000 worth of cosmetics inventory on credit. As of July 1996, Plaintiffs were owed approximately $5.977 million by the United States entities, no part of which has ever been paid to Plaintiffs, and Sefrioui and the Hollisters, while in control of the day-to-day operation of the United States entities that had been formed for the United States franchising business, had spent approximately $5.977 million, which included the $250,000 annual salaries for Sefrioui, G. Hollister and B. Hollister. As of that time, after almost two years of business, only one franchised store and only one company store had been opened.

FIRST CLAIM FOR RELIEF
VIOLATION OF SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 10B-5
(By Plaintiff JPSA Against All Defendants)

22. Plaintiff realleges paragraphs I through 21 and

incorporates same by reference as though fully set forth herein.

23. The representations described above were false and/or misleading. The true facts were as follows:

A. Sefrioui did not have the educational or employment background that he had represented, did not have the level of experience working for McKinsey & Co. that he claimed to have had, had not worked for a number of companies that specialized in drafting Business Plans for retail franchise start-up businesses, had not implemented such Business Plans successfully on a large scale in the United States market, and was not capable and sufficiently experienced to draft realistic Business Plans for the development of a retail cosmetics franchising business in the United States or to implement them successfully.

B. The representations concerning the Hollisters' background were misleading in that the Hollisters' failed to disclose that they had been terminated from their employment at Merle Norman Cosmetics, and that the Hollisters otherwise overstated and misrepresented the extent of their background, experience and level of responsibility.

C. The great majority of the Merle Norman franchise stores had been opened prior to G. Hollister's employment with Merle Norman Cosmetics, G. Hollister had never been personally responsible for the opening of 300

stores in a year, the Merle Norman Cosmetics franchising business was not going to close down in the near future, G. Hollister could not sell Jeanne Piaubert Cosmetics franchises to a large number of persons who had previously bought Merle Norman Cosmetics franchises, and that G. Hollister would not be able to bring in $50 million per year in annual revenue from the Merle Norman franchise store owners to the new United States franchising business or Jeanne Piaubert Cosmetics.

24. Neither the Defendants nor the Hollisters ever provided any specific or meaningful cautionary statements to the Plaintiff with respect to any of the representations, omissions, or non-disclosures made by any of them to the, Plaintiff. Neither the Defendants nor the Hollisters ever disclosed to Plaintiff the falsity or misleading nature of any of their representations, omissions or non-disclosures.

25. The representations, emissions and non-disclosures of Defendants and the Hollisters described above were made in connection with Plaintiff s acquisition of a stock interest in Holdings and Plaintiff's acquisition of the Note from the Limited Partnership. The stock interest and Note

constituted "securities" within the meaning of Section 10 of the Securities Exchange Act of 1934 (15 U.S. C. § 78j) and Rule10b-5 thereunder (17 C.F.R. § 240.10b-5).

26. The United States mail, the telephone, and other instrumentalities of interstate commerce were used in each of the transactions described above.

27. Plaintiff reasonably and actually relied upon the representations, omissions and non-disclosures of Defendants and the Hollisters described above in entering into the transactions and agreements described above. Plaintiff had no prior experience with the franchising business. Plaintiff especially relied on the represented qualifications of Sefrioui and the Hollisters, especially the representations concerning the Hollisters' extensive experience in the operation of a United States franchising business in the cosmetics industry and the representations concerning Sefrioui's extensive experience with the development and implementation of Business Plans for large, national retail companies. If the Plaintiff had known the true facts, Plaintiff would not have entered into the transactions and agreements or purchased the securities described above.

28. Sefrioui and the Hollisters made the representations, omissions and non-disclosures described above with actual knowledge of their falsity and/or misleading nature or with a reckless disregard of their truth or misleading nature. Sefrioui and the Hollisters knew that Plaintiff did not have knowledge of the true facts and that Plaintiff lacked the reasonable means with which to ascertain the true facts. Sefrioui and the Hollisters made their representations, omissions and non-disclosures with the intention of deceiving and inducing Plaintiff into acquiring

the stock interest in Holdings and loaning money to the Limited Partnership, and in entering into the various transactions and agreements described herein, so that Sefrioui and the Hollisters would be in a position to collect $250,000 per year in salary and to start a retail cosmetics franchising business in the United States with the $5 million loaned to the United States companies by Plaintiff.

29. Plaintiff did not discover the falsity of Sefrioui's representations, and did not have knowledge of any facts which would have caused a reasonable person to investigate the representations of Sefrioui until the fall of 1996.

30. As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above, Plaintiff has suffered damages in excess of $6.5 million.

SECOND CLAIM FOR RELIEF VIOLATION OF SECTION 10(B) OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 10B-5

(By Plaintiff FG Limited Against All Defendants)

31. Plaintiff realleges paragraphs I through 21 and incorporates same by reference as though fully set forth herein.

32. The representations described above were false and/or misleading. The true facts were as follows:

A. Sefrioui did not have the educational or employment back ground that he had represented, did not have the level of experience work-in- for McKinsey & Co. that he claimed to have had, had not worked for a number of companies that specialized in drafting Business Plans for retail franchise start-up businesses, had not implemented such Business Plans successfully on a large scale in the United States market, and was not capable and sufficiently, experienced to draft realistic Business Plans for the development of a retail cosmetics franchising business in the United States or to implement them successfully.

B. The representations concerning the Hollisters' background were misleading in that the Hollisters' failed to disclose that they had been terminated from their employment at Merle Norman Cosmetics and that the Hollisters otherwise overstated and misrepresented the extent of their background, experience and level of responsibility.

C. The great majority of the Merle Norman franchise stores had been opened prior to G. Hollister's employment with Merle Norman Cosmetics, G. Hollister had never been personally responsible for the opening of 300 stores in a year, the Merle Norman Cosmetics franchising business was not going to close down in the near future, G. Hollister could not sell Jeanne Piaubert Cosmetics franchises to a large number of persons who had previously bought Merle Norman Cosmetics franchises, and that G. Hollister

would not be able to bring in $50 million per

year in annual revenue from the Merle Norman franchise store owners to the new United States franchising business or Jeanne Piaubert Cosmetics.

33. Neither the Defendants nor the Hollisters ever provided any specific or meaningful cautionary statements to the Plaintiff with respect to any of the representations, omissions, or non-disclosures made by any of them to the Plaintiff. Neither the Defendants nor the Hollisters ever disclosed to Plaintiff the falsity or misleading nature of any of their representations, omissions or non-disclosures.

34. The representations, omissions and non-disclosures of Defendants and the Hollisters described above were made in connection with Plaintiff's acquisition of a limited partnership interest in the Limited Partnership, which limited partnership interest constituted a "security" within the meaning of Section 10 of the Securities Exchange Act of 1934 (15 U.S.C. § 78j) and Rule 10b-5 thereunder (17 C.F.R. § 240.10b-5).

35. The United States mail, the telephone, and other instrumentalities of interstate commerce were used in each of the transactions described above.

36. Plaintiff reasonably and actually relied upon the representations, omissions and non-disclosures of

Defendants and the Hollisters described above in entering into the transactions and agreements described above. Plaintiff had no prior experience with the franchising business. Plaintiff especially relied on the represented qualifications of Sefrioui and the Hollisters, especially the representations concerning the Hollisters' extensive experience in the operation of a United States franchising business in the cosmetics industry and the representations concerning Sefrioui's extensive experience with the development and implementation of Business Plans for large, national retail cosmetics. If the Plaintiff had known the true facts, Plaintiff would not have entered into the transactions and agreements or purchased the securities described above.

37. Sefrioui and the Hollisters made the representations, omissions and non-disclosures described above with actual knowledge of their falsity and/or misleading nature or with a reckless disregard of their truth or misleading nature. Sefrioui and the Hollisters knew that Plaintiff did not have knowledge of the true facts and that Plaintiff lacked the reasonable means with which to ascertain the true facts. Sefrioui and the Hollisters made their representations, omissions and non-

disclosures with the intention of deceiving and inducing Plaintiff into acquiring the limited partnership interest and investing in the limited partnership.

38. Plaintiff did not discover the falsity of Sefrioui's

representations, and did not have knowledge of any facts which would have caused a reasonable person to investigate the representations of Sefrioui until the fall of 1996.

39. As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above, Plaintiff has suffered damages in excess of $75,000.

THIRD CLAIM FOR RELIEF
VIOLATION OF CALIFORNIA CORPORATION CODE SECTION 25401
(By Plaintiffs Against All Defendants)

40. Plaintiffs reallege paragraphs 1 through 39 and incorporate same bb reference as though fully set forth herein.

41. Defendants and the Hollisters materially assisted in the offering or sale of securities to Plaintiffs by means of a written or oral communication which included an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which the), were made, not misleading with the intent to deceive or defraud Plaintiffs in violation of California Corporation Code sections 25401 and 25504. 1.

42. As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above, Plaintiffs have suffered damages in

excess of $6.5 million. Plaintiffs have also suffered incidental and consequential damages.

FOURTH CLAIM FOR RELIEF
FRAUD AND DECEIT
(Against All Defendants)

43. Plaintiffs realleges paragraphs 1 through 39 and incorporate same by reference as though fully set forth herein.

44. Plaintiffs reasonablely and actually relied upon the representations, omissions and non-disclosures of Defendants and the Hollisters described above in entering into the transactions and agreements described above. Plaintiffs had no prior experience with the franchising business.

Plaintiffs especially relied on the represented qualifications of Sefrioui and the Hollisters representations concerning the Hollisters' extensive experience in the operation of a United States franchising business in the cosmetics industry and the representations concerning Sefrioui's extensive experience with the development and implementation of Business Plans for large, national retail companies. If the Plaintiffs had known the true facts, they would not have entered into the transactions and agreements or purchased the securities described above.

45. Sefrioui and the Hollisters made the representations, omissions and non-disclosures described above with actual knowledge of their falsity and/or misleading nature or with a reckless disregard of their truth or misleading nature. Sefrioui and the Hollisters knew that Plaintiffs did not have knowledge of the true facts and that they lacked the reasonable means with which to ascertain the true facts. Sefrioui and the Hollisters made their representations, omissions and non-disclosures with the intention of deceiving and inducing Plaintiffs into entering into the various transactions and agreements described herein, so that Sefrioui and the Hollisters would be in a position to collect $250,000 per year in salary and to start a retail cosmetics franchising business in the United States with the $5 million loaned to the United States companies by Plaintiffs.

46. Plaintiffs did not discover the facts giving rise to their claims alleged herein, and did not have knowledge of any facts which would have caused a reasonable person to investigate the facts, until the fall of 1996.

47. As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above. Plaintiffs have suffered damages in excess of $6.5 million. Plaintiffs have also suffered incidental and consequential damages.

48. The foregoing conduct of Defendants (i) constituted an intentional misrepresentation, deceit, or concealment of a material fact known to the Defendants with

the intention on the part of the Defendants of thereby depriving Plaintiff of property or legal right or otherwise causing Plaintiff injury, (ii) was an intended by Defendants to cause injury to Plaintiff or was despicable conduct that was carried on by the Defendants with a willful and conscious disregard of the rights or safety of others, and/or (iii) was despicable conduct that subjected Plaintiff to cruel and unjust hardship in

conscious disregard of Plaintiff's rights so as to justify an award of punitive damages against Defendants.

FIFTH CLAIM FOR RELIEF
NEGLIGENT MISREPRESENTATION
(Against All Defendants)

49. Plaintiffs reallege paragraphs 1 through 39 and incorporate same by reference as though fully set forth herein.

50. Sefrioui and the Hollisters made the false and misleading representations, omissions, and non-disclosures of material fact described herein above without exercising ordinary or due care, and without having any reasonable basis for believing that any of them was true. Sefrioui and the Hollisters made their representations, omissions and non-disclosures with the intention of inducing Plaintiffs into entering into the various transactions and agreements described herein so that Sefrioui and the Hollisters would be

in a position to collect $250,000 per year in salary and to start a retail cosmetics franchising business in the United States with the $5 million loaned to the United States companies by Plaintiffs.

51. Plaintiffs reasonably and actually relied upon the representations omissions and non-disclosures of Defendants and the Hollisters described above in entering into the transactions and agreements described above. Plaintiffs had no prior experience with the franchising business. Plaintiffs especially relied on the represented qualifications of Sefrioui and the Hollisters, especially the representations concerning the Hollisters' extensive experience in the operation of a United States franchising business in the cosmetics industry and the representations concerning Sefrioui's extensive experience with the development and implementation of Business Plans for large, national into the retail companies. If the Plaintiffs had known the true facts, they would not have entered into the transactions and agreements or purchased the securities described above.

52. As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above. Plaintiffs have suffered damages in excess of $6.5 million. Plaintiffs have also suffered incidental and consequential damages.

SIXTH CLAIM FOR RELIEF

BREACH OF FIDUCIARY DUTY

(By Plaintiffs Against All Defendants)

53. Plaintiffs reallege paragraphs I through 52 and incorporate same by reference as though fully set forth herein.

54. Defendants and the Hollisters were the promoters and organizers of the various corporations and other business entities that were formed pursuant to the agreement for the establishment of the franchising business, including but not limited to Holdings, Management, and the Limited Partnership. As such, Defendants and the Hollisters owed a fiduciary duty to Plaintiffs, who were the initial subscribers and/or co-promoters of the franchising business and of the various corporations and other entities that were created pursuant thereto.

55. In committing the acts alleged above, Defendants breached their fiduciary duty to Plaintiffs.

56. As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above, Plaintiffs have suffered damages in excess of $6.5 million. Plaintiffs have also suffered incidental and consequential damages.

57. The foregoing conduct of Defendants (1) constituted an intentional misrepresentation, deceit, or concealment of a material fact known to the Defendants with the intention on the part of the Defendants of thereby depriving Plaintiff of property or legal right or otherwise causing Plaintiff injury, (ii) was intended by Defendants to cause injury to Plaintiff or was despicable conduct that was

carried on by the Defendants with a willful and conscious disregard of the rights or safety of others, and/or (iii) was despicable conduct that subjected Plaintiff to cruel and unjust hardship in conscious disregard of Plaintiff's rights so as to justify an award of punitive damages against Defendants.

WHEREFORE, Plaintiff prays for judgment against Defendants, and each of them, as follows:

1. For damages compensatory damages according to proof, but at least $6.5 million.

2. For incidental and consequential damages, according to proof.

3. For an order declaring that Defendants hold all the monies, gains and advantages obtained by them, including all monies loaned or transferred by Plaintiffs to Jeanne Piaubert Cosmetics LP or to any other person or entity pursuant to the agreement for the establishment of the United States franchising business for Jeanne Piaubert Cosmetics, as constructive trustees for Plaintiff and compelling Defendants to convey the same to Plaintiff.

4. To the extent that any portion of said monies or property has been transferred by any Defendant, for an order requiring such Defendant to pay Plaintiff an amount equal to the value of property transferred.

5. For an order directing Defendants to account for all of the monies funded by Plaintiffs for the United States franchising business for Jeanne Piaubert Cosmetics, and a further order appointing a special master to investigate and to prepare such an accounting

6. For punitive damages according to proof

7. For prejudgment interest as allowed by law.

8. For costs of suit herein incurred.

9. For such other and further relief as this Court deems just and appropriate.

DATED: APRIL 28, 1997

LAW OFFICES OF
GREGORY A YATES

/s/

By: Gregory Yates
ATTORNEYS FOR
PIAUBERT, S.A. AND
FRAGRANCE GROUP,
LTD.

DEMAND FOR JURY TRIAL

Plaintiffs demand a trial by jury.

DATED: APRIL 28, 1997 LAW OFFICES OF GREGORY A. YATES

/s/

BY: Gregory A. Yates

ATTORNEYS FOR
PIAUBERT, S.A. AND
FRAGRANCE GROUP,
LTD.

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PROOF OF SERVICE

STATE OF CALIFORNIA)
)
OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 9454 Wilshire Boulevard, #850, Beverly Hills, California 90212.

On April 28, 1997, I served the foregoing document described as FIRST AMENDED COMPLAINT on all parties in this action by placing the original /-X-/ a true copy thereof enclosed in a sealed envelope addressed as follows:

ROBERT G. CAMPBELL., ESQ.
THELEN, KARIN, JOHNSON & BRIDGES
333 SOUTH GRAND, SUITE 13400
LOS ANGELES, CA 90071-3193

the original /-X-/ a true copy thereof enclosed in a sealed envelope addressed as follows:

KENNETH NATHANSON, ESQ.
SHERMAN, NATHANSON & MILLER

9454 WILSHIRE BLVD., 1820
BEVERLY HILLS, CA 90212

/-X-/ *(BY MAIL)* I caused such envelope with postage thereon fully prepaid to be placed in the United States mail at Beverly Hills, California.

(BY PERSONAL SERVICE) I caused such envelope to be delivered by hand to the offices of the addressee.

(BY FACSIMILE) I caused such document to be transmute by facsimile to the offices of the addressee.

1 declare under penalty of perjury under the laws of the State of California that the above is true and correct and that am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed at Beverly Hills, California this 28th day April 1997.

/s/
JOHANA RENTERIA

ROBERT G. CAMPBELL, State Bar No. 104274
THELEN, MARRIN, JOHNSON & BRIDGES LLP
333 South Grand Avenue, Suite 3400
Los Angeles, California 90071-3193
Telephone: (213) 621-9800

Attorneys for Defendant
RANDY SEFRIOUI

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

JEANNE- PIAUBERT, S.A., a Corporation, and FRAGRANCE GROUP, LTD., a Corporation, Plaintiffs, vs. RANDY SEFRIOUI, an Individual, Does 1	Case No.: CV-97-0327 HLH NOTICE OF MOTION AND MOTION TO DISMISS FOR TO DISMISS FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED [FRCP 9(b) AND 12(b)(6)] Date: June 9. 1997 Time: 10:00 a.m. Courtroom Of The Honorable Harry L.. Hupp

TO PLAINTIFFS AND THEIR ATTORNEYS OF RECORD:

Please take notice that on June 9, 1997 at 10:00 a.m. or as soon thereafter as the matter may be heard in the above-entitled Court, located at 312 N. Spring Street, Los Angeles, California 90012, Defendant Randy Sefrioui ("Sefrioui") will move the court to dismiss plaintiffs' first three claims for relief for securities fraud pursuant to FRCP 12(b)(6) because plaintiffs' securities fail to state a claim upon which relief can be (granted, and pursuant to FRCP 9(b) because plaintiffs' claims fail to state with particularity each element of fraud and the circumstances constituting the alleged fraud by Sefrioui.

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The Motion is made on the grounds that plaintiffs' federal and state securities fraud claims fail to implicate Rule 10(b) the 1934 Securities Exchange Act, fail to allege the purchase or sale of a "security", in part because the alleged transactions were privately negotiated, one-on-one, and fail to allege facts showing loss causation. The Motion will be made on the further grounds that plaintiffs' securities fraud claims are barred by the one-year statute of limitations.

Finally, this Motion is made pursuant to FRCP 9(b) on the grounds that plaintiffs' securities claims fail to allege with particularity the allegations of fraud and the circumstances constituting a fraud.

The Motion will be based on this Notice of Motion, the Memorandum of Points and Authorities filed herewith, the documents referenced in the original and amended complaints and attached hereto, and the pleadings and papers filed herein.

Dated: May 14, 1997 /s/ Robert G. Campbell

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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

Notwithstanding plaintiffs' tinkering with the original complaint, one inescapable conclusion remains - "[h]owever broad the scope of the Federal Securities laws, this surely is a case that falls outside their expansive boundaries." *Barsy v. Verin* (1981) 508 F.Supp. 952, 957. In the Amended Complaint, rather than plead new facts, plaintiffs omit previously pled facts in an attempt to hide plaintiffs' control over the American entities. However, plaintiffs cannot hide their control and their own creation of the Venture as part of a unique one-on-one negotiated transaction. This case does not implicate the securities laws.

This action involves a multinational cosmetics manufacturer and distributor attempting to expand its global distribution system. It created several American entities and entered numerous transactions (the "Venture") designed to assure its control over the Venture.[1] The

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1/ Attached hereto as Exhibit A is an organizational diagram which accurately reflects the allegations of the original and Amended Complaint. Plaintiffs joined "with Sefrioui and the Hollisters in *creating* a new retail franchise business in the United States ... for the purpose of selling and distributing Jeanne Piaubert Cosmetics products . . ." (Italics added.) (Original Complaint, ¶ 12; Amended Complaint, ¶¶ 10, 11.) Plaintiffs and their affiliates entered into a number of agreements and contracts for these purposes. (Original Complaint, ¶¶ 12, 17, 18 and 19; Amended Complaint, ¶¶ 17-21.) Plaintiffs participated in the creation of two California corporations - Jeanne Piaubert Holdings, Inc. ("Holdings") and

Jeanne Piaubert Management ("Management"). The original complaint alleged that Holdings is the controlling entity."

Venture resulted from a one-on-one, privately negotiated transaction. No interest in the Venture was ever marketed publicly. Plaintiffs now sue Randy Sefrioui ("Sefrioui"), a former employee of the Venture, in retaliation for his filing suit on his employment contract.

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Neither the letter of the law nor policies behind the securities laws are implicated by Plaintiff's claims. Plaintiffs allege that Sefrioui somehow duped plaintiffs into forming companies, entering various transactions and then funding the Venture. While Sefrioui never duped plaintiffs, the policies of protecting the market system or protecting passive investors which underlie Section 10(b) of the Securities Exchange Act of 1934, are not involved here. Desperate to identify some "security" in the transactions alleged, Jeanne Piaubert, S.A. ("JPSA") suddenly contends that the promissory note by one of the venturers, Jeanne Piaubert Cosmetics, L.P. ("Limited Partnership") satisfies the "purchase or sale of a security"

(Complaint, ¶ 22.) "Two-thirds of the shares of Holdings were issued to JPSA," and "[A]l of the shares of Management were issued to Holdings." (Complaint, 17.) Hence, JPSA controls Holdings which in turn controls Management, Sefrioui's former employer. Plaintiffs are commonly controlled. Konckier was and is the President of Plaintiffs. He is also President of plaintiffs' parent Jacques Bogart S.A. and of Holdings. (Complaint, ¶ 5 and Exhibits thereto.) Jacques Bogart S.A. ("JBSA"), is a publicly traded French corporation which owns the stock of Plaintiffs. JBSA is referenced in the original complaint at paragraphs 19 and 20.

requirement. However, as explained below, the note should not implicate the securities laws.

In connection with their securities claims, plaintiffs fail to plead facts demonstrating the purchase or sale of a security. Plaintiffs' securities and common law fraud claims are also conclusorily pled, and fail to specifically identify any materially false representations by Sefrioui. The complaint shows that plaintiffs' securities claims are barred by the one year statute of limitations. Finally, plaintiffs fail to plead loss causation.

II PLAINTIFFS' FEDERAL AND STATE SECURITIES FRAUD CLAIMS SHOULD BE DISMISSED UNDER FRCP 12(B)(6).

In an effort to prevent the court from considering facts set forth in the original complaint, plaintiffs' omit allegations previously pled. As already decided by this court, those facts previously pled conclusively showing plaintiffs' control of the Venture and the fact that this was a privately negotiated one-on-one transaction. Plaintiffs will undoubtedly attempt to persuade the court that it is now deprived from considering those earlier admissions. However, in connection with a Rule 12(b)(6) motion, the court is permitted to consider and take judicial notice of all admissions in its own files (*Jones v. Hinton*, 847 F. Supp. 41 (E.D. Pa. 1994)), pleadings in previously filed state court actions *(Henson* v. CSC Credit Services, 29 F.3d 280 (7th Cir. 1994)), documents referenced in a complaint but not attached *(In Re Gupta Corp. Sec. Litigation,* 900 F. Supp. 1217 (N.D, Cal. 1994)), and facts discernible from documents attached to the complaint. *Durning v.* First

Boston Corp., 815 F.2d 1265 (9th Cir. 1987). Such consideration does not convert the motion to one for

summary judgment. *Branch v.* Tunnell, 14 F.3d 449, 454 (9th Cir. 1994).

Plaintiffs cannot escape their prior admissions by conclusorily contradicting them in the Amended Complaint. The general rule of notice pleading does not apply in Rule 10b-5 litigation. Instead, such claims must be pled "with particularity" under Rule 9(b). As discussed below, conclusory allegations are insufficient. *SEC* v. *Seaboard Corp.*, 677 F.2d 1315, 1316 (9th Cir. 1982). The court need not accept unreasonable inferences or unwarranted deductions of fact. *Western Mining Council* v. *Watt*, 643 F.2d 618, 624 (9th Cir. 1981). On a motion to dismiss pursuant to Rule 12(b)(6), "courts will examine whether conclusory allegations follow from the description of facts as alleged by plaintiff." *Brian Clewer*, Inc. v. *Pan American World Airways, Inc.*, 674 F.Supp. 782, 785 (C.D. Cal. 1986). Moreover, where documents are attached to a complaint and incorporated by reference, and those documents contradict allegations in the complaint, the court may disregard those allegations. *Durning v. First Boston Corp.*, 815 F.2d 1265 (9th Cir. 1987).[2]

2/ Business plans 1, 2 and 3 were referenced in the Original Complaint and attached thereto as exhibits 1, 2 and 3. In the Amended Complaint, none of the business plans are attached, although paragraph 15 references an undated and unspecified "Business Plan". (The business plans are attached hereto as Exhibit B.) Similarly, in paragraphs 18, 19, 20, and 22, plaintiffs

variously referred to "an Agreement Of Limited Partnership" (Exhibit C), "a Shareholders Agreement Among Plaintiff JPSA, Sefrioui, the Hollisters, and Holdings" (Exhibit D), "an Option Agreement Among Plaintiff JPSA, Sefrioui, the Hollisters, and Holdings (including a redrafted"/Amended Option Agreement)" (Exhibit E), "a Licensing Agreement Between Plaintiffs JPSA, JBSA, and Jeanne Piaubert Cosmetics, L.P." (Exhibit F), a "Promissory Note" (Exhibit G) and "Employment Contracts ... Guaranteed by Plaintiff JBSA" (Exhibit H). In the Amended Complaint, specific reference to certain of these documents, but not all of them, is omitted. What is substituted are vague repetitive allegations to "the agreements and transactions described below" (Amended Complaint, ¶ 11) "in furtherance of the agreement between Plaintiffs, the Defendants and the Hollisters for the establishment of the United States franchising business . . ." (Amended Complaint, ¶¶ 16-21.) Because they are referenced and

A. <u>The Transactions Alleged Do Not Involve The Purchase Or Sale Of A Security</u>.

In order to make out a claim under Section 10 of the Securities Exchange Act of 1934 (15 U. S.C. § 78j), plaintiffs must allege with particularity misrepresentations made in connection with the purchase or sale of a security. Hocking v. *Dubois,* 885 F.2d 1449, 1455 (9th Cir, 1989). These fundamental requirements are not satisfied by the complaint.

1. <u>JPSA Does Not Allege A "Purchase" Of Shares In Holdings</u>.

Violations of Section 10(b) are limited to purchasers or sellers of securities. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 95 S. Ct. 1917 (1975). Plaintiffs engage in artful pleading to avoid the "purchase or sale" requirement. JPSA alleges that "[T]wo-thirds of the outstanding shares of the common stock of Holdings was issued to JPSA."[3] (Amended Complaint, ¶16.) However,

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relied on by plaintiffs, this court is permitted to consider them.

3/ In an effort to conceal JPSA's control over the Venture so evident in the original complaint, plaintiffs remove from the Amended Complaint the factual allegation that Holdings owns the stock of Management and is the "controlling entity." However, by omitting these allegations Holdings is now entirely disconnected from the Venture. No allegations connect Holdings to either Management or the Limited Partnership. In this instance, plaintiffs are so bashful about the facts, it backfires on them. Only by resort to the Original Complaint is any clarity given to the elements of, and transactions constituting, "the

JPSA falls to allege, and cannot allege in good faith, that it paid a nickel for those shares. Therefore, JPSA fails to identify a "purchase or sale" of any security within the meaning, of the 1934 Securities Exchange Act. The "Note" cannot satisfy this requirement. JPSA's Note was to Jeanne Piaubert Cosmetics, L.P., not Holdings. (Amended Complaint, ¶ 18, Exhibit G hereto.) Absent payment to Holdings for the stock, JPSA has no actual damage and no standing to sue in connection with it. In addition, JPSA created the Venture (as shown below) and essentially issued stock to itself.

Furthermore, JPSA will claim that stock is per se a security. However, this ignores the substance of the transactions. FPSA funded the Venture. It did not invest in stock. The shares in Holdings were simply a means of asserting control and incidental to the totality of the transactions.

2. The Transactions Alleged Do Not Qualify As Investment Contracts Because They Flunk The *Howey* Test.

Plaintiffs cannot properly characterize their finding of the Venture as an "investment contract" under Section

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establishment of the United States franchising business for Jeanne Piaubert Cosmetics." (Amended Complaint, ¶¶ 16-21.)

4/ The term "security" is defined as including any "investment contract." 15 U.S.C. § 78c(1)(10).

10(b).[4] Courts will scrutinize a transaction which is the subject of a 10(b) claim to determine whether an "investment contract" exists. The leading case on this subject is *SEC v. W.J. Howey, Co.*, 328 U. S. 293, 66 S.Ct. I I 00 (I 946)[5]. In that case, the court defined an "investment contract":

> "an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party ..." *Id.* at 298-99, 66 S.Ct. At 1103.

Plaintiffs allege that JPSA funded the Venture in accordance with business plans adopted by the parties. (See Original Complaint, ¶¶ 16 and 20 and Business Plans Exhibit B; Amended Complaint, ¶ 15.) "Plaintiffs' funding continued throughout the remainder of 1994 and totaled $980,000 by the end of that year." (Amended Complaint, ¶¶ 20.) These allegations of funding the transactions fail to satisfy the definition of an "investment contract."

Plaintiffs' allegations fall at least one element of the *Howey* test -- "profits to come solely from the efforts of

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5/ California Courts also employ the *Howey* test to determine whether a transaction is a security under the California Corporate Securities Act. *Moreland, supra,* 239 Cal.Rptr. at 562 (concluding that no investment contract existed since Plaintiff failed to satisfy "common enterprise" and passive investor requirements to *Howey).*

others." *Id.* at 301. This "control" test is designed to limit claims to those of passive investors. The Ninth Circuit has slightly softened this control test; the test is satisfied when "the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which effect the failure or success of the enterprise." *SEC* v. Glenn W. Turner Enter., Inc., 474 F 2d 476 (9th Cir. 1973), cert. denied, 414 U.S. 821, 94 S.Ct. 117.

Nevertheless, where an investor is not passive and retains significant control over a venture courts have consistently found no security to exist. In this Circuit, "the leading case on the control issue" is *Williamson v. Tucker,* 645 F.2d 404, 418 (5th Cir. 1981) cert. denied, 454 U.S. 897, 102 S.Ct. 396. Hocking v. *Dubois,* 885 F.2d 1449, 1460 (9th Cir. 1989).[6]

6/ *Williamson* is recognized in this Circuit as the leading case on the *Howey* control test. *Hocking,* 885 F.2d 1449 at 1460. According to *Williamson,* an investor must establish that: "(1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; or (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or. managerial ability of the promoter or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers." *Williamson,* 645 F.2d at 424.

Plaintiffs cannot satisfy the requirements of *Williamson.* With respect to the *first prong* of the *Williamson* test, the allegations of the complaint demonstrate plaintiffs' far reaching control over the enterprise. Plaintiffs readily admitted this control: **"WHEREAS, Bogart owns and controls IJP, JP[SA] and Fragrance and indirectly controls the Licensee [Limited Partnership]."** (Exhibit F, p. 164.) Exhibits B through H demonstrate that the Venture was created by plaintiffs to assure them control. The Venture was not created and later marketed to them.

The original complaint alleges that Plaintiffs and Defendants together formed (Original Complaint, ¶¶ 17 and 19), co-promoted (Original Complaint, ¶ 46) and funded (Original Complaint, ¶ 21) a "new business venture" which proved unsuccessful. Plaintiffs allege that they adopted the *third* business plan presented to them containing "projections and/or forecasts," (Original Complaint, ¶16.) According to exhibits to the complaint (Exhibit B hereto), Konckier rejected the first two business plans and adopted the third version. The cover page to Business Plan No. 3 states: "Submitted by the team Sefrioui/ Hollisters after I [Konckier] personally told them their plan number 2 was totally unrealistic." (Exhibit B, p. 67.) "Business plan 3 . . .was attached to and incorporated into each of these employment contracts, and Sefrioui and the Hollisters represented

that they would implement Business Plan number 3..." (Original Complaint, ¶ 20.)[7]

Plaintiffs omit these material and factual allegations in the Amended Complaint. However, as stated above, admissions in the earlier complaint and other matters now part of the court's file do not so readily disappear. *Jones v. Hinton, supra,* 847 F. Supp. 41; *Branch v. Tunnell,* 14 F.3d 449, 454 (9th Cir. 1994) (documents mentioned in Amended Complaint but not attached may be considered on motion to dismiss).

Not only did plaintiffs exert control by rejecting the earlier "unrealistic" business plans, but by structuring the Venture to assure it control. According to the original complaint, FPSA controls Holdings (the "controlling entity") which owns all of the shares of Management. (Complaint, ¶¶ 17, 18 and 22; see also Amended Complaint, ¶ 16.) Management is the general partner of the operating limited partnership. (Amended Complaint, ¶ 17, See Exhibit A.) The mere fact that Sefrioui was employed as chief operating officer of the Venture and participated in the day-to-day operations of the Venture does not negate plaintiffs' ultimate control. JPSA's effective control over the general partner of the limited partnership negates the possibility that its interest in the Venture can be regarded as a security. *Fra.zier v. Manson,*

7/ The Hollisters were forced to resign seven months after execution of their employment contracts in January, 1995, and were not paid "annual salaries." The Hollisters are presently suing Jacques Bogart S.A. in the Los Angeles Superior Court for breach of a settlement agreement.

484 F.Supp. 449, affirmed, 651 F.2d 1078 (D.C, Tex. 1980).

Plaintiffs' conclusory allegations added to paragraph 17 (which merely parrot legal conclusions set forth in pertinent cases) are overcome by contrary specific facts set forth in the original complaint and in documents referenced in or attached to the complaints. It Is well settled that the court should not accept as true conclusory allegations or mere legal conclusions, such as those pled by plaintiffs. *Western Mining Council v. Wall,* (9th Cir. 1981) 643 F.2d 618, 624; *SEC v. Seaboard Corp.,* 677 F.2d 1315, 1316 (failure to plead facts showing scienter in securities

fraud action results in dismissal). Mere legal conclusions and conclusory allegations should particularly be rejected where contradicted by facts which may be judicially noticed. *Mullis v. U.S.. Bank. Ct.,* 828 F.2d 1385, 1388 (9th Cir. 1987).

Plaintiffs' interest in the Venture is not consistent with the passive role of a limited partner. Plaintiffs participated in "creating" the Venture (Original Complaint, ¶ 12-1 Amended Complaint, ¶ 11) and were its "co-promoters." (Original Complaint, ¶ 46.) Plaintiffs (with Sefrioui) *"formed,* Jeanne Piaubert Holdings, Inc.... and Jeanne Piaubert Management, Inc." (Italics added.) (Original Complaint, ¶ 17.) Plaintiffs -- "for the establishment of the United States franchising business" - entered into a series of agreements including the limited partnership agreement for Jeanne Piaubert Cosmetics, L.P. (Original Complaint, ¶¶ 18 and 19.) Plaintiffs formed, created, structured, and

co-promoted the Venture. (Exhibits B through H.) They also controlled the Venture through their ability to terminate the officers of the Venture entities pursuant to the terms of the employment contracts referenced in both complaints (Exhibit H) and their ability to control its funding. (Promissory Note, Exhibit G hereto.)

Plaintiffs also cannot satisfy the *second prong* of the *Williamson* control test, plaintiffs were not incapable of exercising control due to inexperience or unsophistication. In *Deutsch Energy Co. v. Mazur,* 813 F.2d 1567 (9th Cir. 1987) the court found that purchasers of oil well sites for $1.5 million were not "inexperienced and unknowledgeable members of the general public" and therefore were not incapable of exercising management powers over the investment. Id. at 1570. The investors' primary business was the operation of convalescent hospitals in California where they also resided. Whereas, the drilling partnership in which they invested was located in Kansas. The court rejected the investors' contention that they were prevented from exercising meaningful control since they resided in a different state from the drilling projects and due to their lack of sophistication in such ventures. Id. at 1570. The court rejected these claims since the plaintiffs had "general business expertise from other sophisticated business transactions." Id. at 1570.

Plaintiffs cannot and do not allege that they are "so inexperienced and unknowledgeable in business affairs" that they could not exercise the control retained by them.

This is demonstrated by the actual control plaintiffs retained as described above. In addition, plaintiffs are

hardly inexperienced. They are controlled by JPSA and part of the multinational "Groupe Bogart." (See Exhibit B, Plan No. 1.) Plaintiffs are also in the same business as the Venture - the distribution and sale of Jeanne Piaubert Cosmetics. (Original Complaint, ¶ 3.)

Finally, plaintiffs cannot meet the *third prong* of the *Wilkinson* control test since they were not dependent on any unique ability of Sefrioui. The complaint does not allege that Sefrioui had any background whatsoever in the cosmetics business. (Amended Complaint, ¶12.) Indeed, Sefrioui had no experience in the cosmetics business which was known to plaintiffs. To the contrary, it is clearly inferable from the complaint that to the extent plaintiffs relied on anyone other than themselves with respect to the "new business venture" they relied on the Hollisters. (Original Complaint, ¶ 14; Amended Complaint, ¶¶ 13 and 14.) The complaint falls to show any unique ability in Sefrioui on which plaintiffs relied.

In much closer cases than this, it has been repeatedly held that plaintiffs who exercised significant control cannot claim "reliance upon another's skill." *It Re National Mortgage Equity Corp., supra*, 723 F. Supp. at 505 (purchasers of pooled, mortgage-backed certificates through institutional brokerage held not reliant on skill of brokerage firm and third prong of *Howey* test not satisfied). As demonstrated above, JPSA controlled the Venture.

Therefore, plaintiffs cannot claim reliance on any unique ability in Sefrioui. Plaintiffs' description of the Venture flunks each prong of *Williamson's* control test,

and does not satisfy *Howey's* definition of an "investment contract."

Numerous cases addressing whether a transaction should be characterized as an "investment contract" for purposes of section 10(b) support Sefrioui. In *Power Petrol, Inc. v. P&G Mining Co.,* 682 F. Supp. 492 (D.C. Colo. 1988), the court granted defendants motion to dismiss, finding that plaintiff was not "merely a passive investor." The court held that the transaction did not constitute an "investment contract", and, therefore, a "security" within the meaning of the federal securities laws. *Id.* at 494 (treating motion to dismiss as motion for summary judgment). Like the plaintiffs in *Power Petroleums,* plaintiffs herein have structured the enterprise to retain effective control over Management and hence Jeanne Piaubert Cosmetics,

L.P., and by executing employment contracts with Sefrioui and the Hollisters for the alleged purpose of requiring execution of a plan adopted by plaintiffs.

In *Holden v. Hagopian,* 978 F,2d II 15 (9th Cir. 1992) the court dismissed, under FRCP 12(b)(6), plaintiffs federal securities claims under Section 10(b) and companion California state law claims. *Id.* at 1117. The court held that plaintiffs failed to plead facts supporting, a finding that plaintiffs interest in a horse racing venture constituted an "investment contract" and, therefore, failed to implicate Section 10(b). *Id.* at 1 123. The complaint failed the *Howey* definition of an "investment contract" under the *Williamson analysis. Id.* at 11 19-23.

Like plaintiffs in the instant case, the plaintiffs in *Holden* exercised legal control over the managing general partner. *Id.* at 1120. Similar to plaintiffs herein, the *Holden* plaintiffs failed to allege "facts showing that they lack general business experience or are unknowledgeable about business generally." *Id.* at 1121. Finally, the *Holden* plaintiffs failed to "show that they were dependent on some 'non-replaceable expertise' on the part of the promoter or manager . . ." *Id.* at 1122 (citing *Williamson, supra.).* JPSA and Fragrance Group do not allege that Sefrioui possessed any "non-replaceable expertise." Sefrioui's resume itself (Exhibit B, p. 49), and description of his background (Amended Complaint, ¶ 12), show that Sefrioui holds an MBA and has a background as a business consultant. These are hardly unique qualifications making Sefrioui irreplaceable.

Pursuant to the reasoning in *Holden* and other above-cited cases, plaintiffs' complaint should be dismissed. Plaintiffs' control over the Venture deprives them of any "securities" claim; under *Howey,* the Venture was not an "investment contract." Plaintiffs were not passive investors. Plaintiffs created the Venture. They did not buy into an existing enterprise.

B. **The Transactions Alleged In The Complaint Were Negotiated One-On-One And Were Not Designed To Be Publicly Traded.**

It has been consistently held and is well-settled that a "private agreement, negotiated directly and individually by the parties, is not a security." *Mace Neufeld Productions v. Orion Pictures Corp.*, 860 F.2d 944, 946 (9th Cir.

1988). In *Mace,* the plaintiff entered into a written contract with Orion Pictures and a producer pursuant to which the plaintiff would invest cash and

would receive a net profit interest from revenues derived from the production of a television series. *Id.* at 945. The court cited and relied on *Marine Bank v. Weaver,* 455 U.S. 551, 102 S.Ct. 1220 (1982), for the proposition that, "a private agreement that provided for one party to share in the profits generated entirely by the other party's business did not fall within the definition of a security under the 1934 Act because the agreement was not publicly offered or traded, it was unique, and it was negotiated 'one-on-one' by the parties." *Mace, supra,* 860 F.2d at 946. The court affirmed the dismissal of the complaint under FRCP 12(b)(6) holding, "[U]nder the reasoning *of Marine Batik,* it is not the type of contract that Congress intended to be included within the definition of a security under the 1934 Act. Congress' purpose in enacting this legislation was to protect public investors and to restore confidence in U.S. markets. [Citations omitted] The Act was not intended to extend to ordinary, individually negotiated private commercial loan transactions." *Id.* at 947.

The decisions in *Mace Neufeld Productions and Marine Bank* are controlling here.[8] The complaint

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8/ The holding in *Marine Bank, supra,* has been widely adopted. *BAMCO 18 v. Reeves, 675* F.Supp. 826 (S.D.N.Y. 1987) (complaint dismissed pursuant to FRCP 12(b)(6) where 1-On-1 negotiations resulted in at best two limited partners); *In Re National Mortgage v. Equity Corp., supra,* 723 F.Supp. at 503 (dismissal where investors "able to negotiate their purchases to suit their needs "); *Tab*

describes a unique transaction negotiated one-on-one between the parties which was never designed to be publicly traded. According to the complaint, "defendant Hollisters/Sefrioui Group" made a pitch to Konckier in Paris. (Original Complaint, ¶ 16.) An acceptable business plan was developed. (Original Complaint, ¶ 16.) Thereafter, the two sides structured an agreement, formed companies and entered transactions to suit their particular interests. (Original Complaint, ¶¶ 17-19; see Exhibits B through H.) This was a privately negotiated transaction. It is not the type of transaction Congress intended to be regarded as a security under the 1934 Act. The securities fraud claims must, therefore, be dismissed.

C. **The Promissory Note Is Not A Security.**

Although the definition of "security" includes notes, courts look to the economic reality of the transaction before concluding whether to invoke the federal securities laws. The courts are not bound by legal formalisms and the phrase "any note" in the definition of a security should not be literally interpreted to mean "any note." *Reves v. Ernst & Young,* 494 U.S. 56, 62-3, 110 S.Ct. 945 (1990). In *Reves,* the court addressed the factors and characteristics which make a note a security or non-security. The Court concluded that notes sold to at least 1,600 of 23,000 farming co-op members, as well as non co-op members, and which were mass marketed as an

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Partnership v. Grantland Financial, 866 F.Supp. 807 (S.D.N.Y. 1994).

"Investment Program" with "more than 11,000,000 in assets to stand behind your investments" constituted a security. *Id.* at 67-68.

The present case bears no resemblance to *Reves.* No sale or purchase of a note took place. No marketing occurred. No market for the note exists or is alleged. It is a unique instrument negotiated one-on-one by the parties, Plaintiffs simply funded a start-up venture which they and Bogart created and controlled. Funding took the form of periodic advances in the nature of an open book account for operating purposes. The note had no ability to appreciate in value according to any market. Like a lender's note, repayment consists exclusively of interest and principal. A note under such circumstances is not a security.

In *Vainberg v. Minnick,* 760 F. Supp, 315 (S.D.N.Y. 1991), a wealthy investor made unsecured loans to a partnership in which the investor's husband was a partner. The loan reflected advances made from time to time to the partnership as endorsed on a schedule on the back of the note. *Id.* at 320, fn. 8. In this regard, Limited Partnership's note to JPSA is virtually identical. The advances made in *Vainberg* were invested in eight different speculative ventures which were all unprofitable. Plaintiffs alleged misrepresentations by various advisors and the partnership. The court analyzed the "economic reality" of the note and concluded that "the note was drafted as a means of recording open account loans." *Id.* at 326. The court held the note was not a security. *Id.* at 326. The court cited several factors which are present here in concluding that no security exists. Both notes are

"custom-drafted." *Id.* at 325. The parties did not contemplate "a

secondary market" for the notes. *Id* at 325. "In view of the uniqueness of the note, offering to other investors seems highly unlikely." *Id.* at 325. Finally, "the investing public would not be likely to regard it as a security." *Id.* at 325. Each of these factors militate against finding that the JPSA note is a security. *Equitable Life Assur. Soc. v. Arthur Anderson & Co., 655* F. Supp. 1225 (1987) ($8 million in promissory notes privately placed to insurance company to provide working capital held no security).

The Marine Bank decision and its progeny are also relevant to this analysis. "Federal Securities laws are not properly invoked where a loan results from direct negotiations between the parties." *Tab Partnership v. Grantland Fin. Corp.,* 866 F. Supp. 807 (S.D.N.Y. 1994). Like the *Tab Partnership* case, the JPSA note "was arrived at through one-on-one negotiation and ... plaintiffs did not allege that the agreement would be traded publicly or that a prospectus would be distributed." *Id.* at 809. Consequently, for many of the same reasons no "investment contract" exists, the JPSA note should not be considered a security. From the state of the law this is fairly obvious. This is probably why plaintiffs did not assert the note as a security in the original complaint.

D. Plaintiffs' Securities Claims Are Barred by the Statute of Limitations.

A claim for fraud under section 10(b) is barred unless filed within one year after discovery of the facts

constituting the violation and within three years after such violation. *Lampf v. Gilbertson,* 501 U.S. 350, 364, 1 11 S.Ct. 2773 (1991). The complaint shows that by May, 1995, plaintiffs necessarily knew the facts which they now allege constitutes a violation by Sefrioui. However, they did not file this action until January 16, 1997.

Plaintiffs allege that Sefrioui solicited Konckier, president of both plaintiffs, in December, 1993. (Amended Complaint, Complaint ¶ 10.) Thereafter, meetings in Paris were held from January through March, 1994, and representations were made by Sefrioui and the Hollisters from January through May, 1994 – the notorious "Communications." (Amended Complaint, ¶ 11.)

The alleged "Communications" plaintiffs attribute to Sefrioui all concern his and the Hollisters' ability to satisfy the projections of the Business Plan. Sefrioui sent plaintiffs "his resume prior to March 17, 1994." (Amended Complaint, ¶ 12.) Sefrioui's "resume" is attached to "Business Plan No. I"

(Exhibit B, p. 49) and was submitted to plaintiffs in February, 1994. (Original Complaint, ¶ 16.) Plaintiffs contend that Sefrioui represented in his resume "that he was familiar with drafting business plans with respect to retail operations and successfully implementing them." (Amended Complaint, ¶ 12.) "In these business plans, Sefrioui and the Hollisters represented, based upon their business experience . . that they would be able to open *in the first year of business* ... 120 franchised stores under Plan 3." (Italics added.) (Original Complaint, ¶ 16; see

Amended Complaint, ¶ 15.) "Business Plan 3" was presented to plaintiffs in March or April, 1994, and was represented to be "realistic, reachable, achievable and doable." (Original Complaint, ¶ 16; Amended Complaint, ¶ 15.) Therefore, the answer to whether 120 franchise stores could be opened in the first year, was necessarily known at the end of that year - by May, 1995.

Having opened only one franchise and one company store (Amended Complaint, ¶ 21), plaintiffs knew by May, 1995, one full year after its adoption, that Business Plan 3's projection of 120 opened stores by the end of the first year was not "achievable." As for any assurances suggesting that the Business Plan was achievable, and to the extent plaintiffs construed such assurances as a guarantee that the Business Plan would be successfully implemented, plaintiffs knew by May, 1995, at the very latest, that such guarantee was untrue. Therefore, plaintiff's federal securities fraud claim under section 10(b) is clearly barred by the one year statute of limitations.

E. Plaintiffs' State Securities Claim Must Be Dismissed Because Strict Privity Does Not Exist.

Plaintiffs also allege violations of California Corporations Code Sections 25402 and 25504.1. However, under California law, "[A] violation of section 25401 requires privity between the seller of a secured instrument and a purchaser." *Empl. Ins. Of* Wausau v. M*usick, Peeler & Garrett*, 871 F. Supp. 381, 387 (S.D.Cal. 1994); *Mirkin v. Was*erman, 5 Cal, 4th 1082, 1104, 23

Cal.Rptr. 2d 101 (1993). Not only is the application of section 25401 "limited to actual sellers," because section 25504.1 (joint and several liability) is derived from section 25401, a failure to plead "strict privity" defeats this derived claim. *Empl Ins. Of Wausau, supra,* 871 F.Supp. at 387.

There is no alleged privity between Sefrioui and plaintiffs. In fact, the allegations make clear that Sefrioui himself was no seller of any security at all, much less to plaintiffs. Therefore, the third claim for relief must be dismissed for this additional reason. *In Re Diasonics Litigation,* 599 F.Supp. 447, 459 (1984) ("Lacking an allegation of such privity, the plaintiffs claim under section 25401 must be dismissed.")

F. Plaintiffs Fail To, And Cannot, Allege Loss Causation.

Causation is an essential element to Plaintiff's security claims. Plaintiffs must plead and prove two kinds of causation -- *transactional* causation and *loss* causation. The term *transactional* causation is synonymous with the concept of reliance. In other words, plaintiffs relied on a misrepresentation in *entering* a transaction. Plaintiffs repeatedly allege that "*as a result of the representations,* omissions and non-disclosures of Sefrioui and the Hollisters" plaintiffs *entered into* various transactions." (Italics added.) (Amended Complaint, ¶¶ 16-21.) This is an allegation of mere *transactional* causation, not *loss* causation.

Federal courts have routinely held that a plaintiff must also plead and prove *loss* causation, namely, that the wrong caused the plaintiffs economic loss. *Huddleston v. Herman & MacLean,* 640 F.2d 5'34 (5th Cir. 1982), affirmed in part, reversed in part on other grounds, 459 U.S. 375 (1983). Loss causation is an accepted requirement. *In Re Catanella & E.,F. Hutton, Inc.,* Securities Litigation, 583 F.Supp. 1388 (E.D. PA. 1984). Not only do plaintiffs not allege loss causation, it cannot be inferred from the complaint. Loss causation cannot be assumed. It must be pled with particularity. *Bastian v. Petren Resources Corp.*, 892 F.2d 680 (7th Cir. 1990). Plaintiffs fail to allege a direct nexus between Sefrioui's alleged representations and any decline in value in any investment. They fall to allege loss causation. This court should not accept plaintiffs' conclusory allegations that it "suffered damages" as a "direct and proximate result of the acts, omissions and non-disclosures of the Defendants."

III. PLAINTIFFS' CLAIMS ARE NOT PLED IN ACCORDANCE WITH FRCP 9(b).

Under Rule 9(b) Federal Courts require a complaint to state the who, what, where, how and when of an alleged fraud. False statements must be alleged with particularity. *Stack v.*

Lobo, 903 F.Supp. 1361 (N.D.Cal. 1995). Plaintiffs must allege *why* the alleged misrepresentations were false when made, and the true facts then existing. *Decker v. Massey-Ferguson, Ltd.,* 681 F.2d 111 (2d Cir. 1982).

Each claim for relief is premised on the same vague and conclusory allegations of fraud. Beginning in paragraph 11 of the complaint, plaintiffs recite various "representations" by Sefrioui and the Hollisters. (Amended Complaint, ¶¶ 11 -15.) Although representations are alleged, there is no statement in these paragraphs that the allegations are false. Not until paragraph 23(A) is there an allegation of falsity. However, there is no allegation of how the representations are false. For example - "Sefrioui did not have the educational or employment background that he represented . . ." In what material respect? Rule 9(b) requires plaintiffs to specifically state how Sefrioui misrepresented his background and resume. Plaintiffs fail to allege the true facts then existing as required. Combining a list of neutral facts and a general conclusory, allegation of fraud is insufficient. *Stack, supra,* 903 F. Supp. at 1367.

IV. CONCLUSION.

For the foregoing reasons, the securities claims should be dismissed with prejudice.

Dated: May 14, 1997 Respectfully Submitted,

/s/ Robert G. Campbell
ROBERT G. CAMPBELL
THELEN, MARRIN, JOHNSON
& BRIDGES LLP
Attorneys for Defendant
RANDY SEFRIOUI

EXHIBIT "C"

AGREEMENT OF LIMITED PARTNERSHIP
OF
JEANNE PIAUBERT COSMETICS, LIMITED
PARTNER
a California Limited Partnership

This AGREEMENT OF LIMITED PARTNERSHIP (the "Partnership") is entered into and shall be effective as of the 15th day of April, 1994 by and between Jeanne Piaubert Management, Inc., a California corporation, as the "General Partner," and the Persons whose names are set forth on Exhibit A attached hereto and incorporated by reference herein, as the "Limited Partners," pursuant to the provisions of the California Revised Limited Partnership Act, on the following terms and conditions:

Section I
THE PARTNERSHIP

1.1. FORMATION. The Partners hereby agree to form the Partnership as a limited partnership pursuant to the provisions of the Act and upon the terms and conditions set forth in this Agreement.

1.2. PARTNERSHIP NAME. The name of the Partnership shall be Jeanne Piaubert Cosmetics, LP, a California Limited Partnership. The Partnership shall do business under the name "Jeanne Piaubert Cosmetics,

Ltd," or such other similar name as selected by the General Partner. The General Partner may change the name of the Partnership upon ten (10) Business Days notice to the Limited Partners.

1.3. The purpose of the Partnership is to develop, support, manage, supply and franchise independently owned cosmetic stores under the "Methode Jeanne Piaubert" trade name and proprietary system, and to engage in any and all activities related or incidental thereto.

1.4. PRINCIPAL PLACE OF BUSINESS. The principal place of business of the Partnership shall be at 1901 Avenue of the Stars, Suite 1100, Los Angeles, CA 90067. The General Partner may change the principal places of business of the Partnership to any other place within or without the State of California upon ten (10) Business Days notice to the Limited Partners.

1.3. TERM. The term of the Partnership commenced on April 15, 1994 (the date the certificate of limited partnership (the "Certificate") was filed in the office of the Secretary of State of California in accordance with the Act) and shall continue until the winding up and liquidation of the Partnership and its business is completed following a Liquidating Event, as provided in Section 13 hereof.

1.6. FILINGS; AGENT FOR SERVICE OF PROCESS.

(a) The General Partner has caused the Certificate to be filed in the office of the Secretary of State of California in accordance with the provisions of the Act. The General Partner shall take any and all other actions reasonably necessary to perfect and maintain the status of the Partnership as a limited partnership under the laws of California. The General Partner shall cause amendments to the Certificate to be filed whenever required by the Act. Such amendments may be executed by any General Partner or by any Person designated in the amendment as a new General Partner. The General Partner shall cause a certified copy of the Certificate and any amendments thereto to be recorded in the office of the county recorder in every county in California in which the Partnership owns real property.

(b) The General Partner shall execute and cause to be filed original or amended certificates and shall take any and all other actions as may be reasonably necessary to perfect and maintain the status of the Partnership as a limited partnership or similar type of entity under the laws of any other states or jurisdictions in which the Partnership engages in business.

(c) The registered agent for service of process on the Partnership shall be Gipson Hoffman &. Pancione, a Professional Corporation or any successor as appointed by (the General Partner in accordance with the

Act. The registered office of the Partnership in the State of California is located at c/o Gipson Hoffman & Pancione, a Professional Corporation, 1901 Avenue of the Stars, Suite 1200, Los Angeles, CA 90067-6002.

(d) Upon the dissolution of the Partnership, the General Partner (or, in the event there is no remaining General Partner, any Person elected pursuant to Section 13.2 hereof) shall promptly execute and cause to be Filed certificates of dissolution in accordance with the Act and the laws of any other states or jurisdictions in which the Partnership has filed certificates.

1.7. TITLE TO PROPERTY. All real and personal property owned by the Partnership shall be owned by the Partnership as an entity and no Partner shall have any ownership interest in such property in its individual name or right, and each Partner's interest in The Partnership shall be personal property for all purposes. Except as otherwise provided in this Agreement, the Partnership shall hold all of its real and personal property in the name of the Partnership and not in the name of any Partner. The foregoing notwithstanding, a Partnership shall enter into the License Agreement between the Partnership and an affiliate of a limited partner.

1.8. PAYMENTS OF INDIVIDUAL OBLIGATIONS. The Partnership's credit and assets shall be used solely for the benefit of the Partnership, and no asset of the Partnership shall be transferred or encumbered for or in payment of any individual

obligation of any Partner.

1.9. INDEPENDENT ACTIVITIES; TRANSACTIONS WITH AFFILIATES.

(a) Each General Partner and any of its Affiliates shall be required to devote only such time to the affairs of the Partnership as such General Partner determines in its sole discretion may be necessary to manage and operate the Partnership, and each such Person, to the extent not otherwise directed by such General Partner, shall be free to serve any other Person or enterprise in any capacity that it may deem appropriate in its discretion.

(b) Insofar as admitted by applicable law, and except as prohibited or regulated pursuant to one or more written agreements between or among the Partners, each General Partner, (acting on its own behalf) and each Limited Partner (acting on its own behalf) may, notwithstanding this Agreement, engage in whatever activities they choose, whether the same are competitive with the Partnership or otherwise, without having or incurring any obligation to offer any interest in such activities to the Partnership or any Partner and neither this Agreement nor any activity undertaken pursuant hereto shall prevent any Partner from engaging in such activities, or require any Partner to permit the Partnership or any Partner to participate in any such activities, and as a material part of part of the consideration for the execution

of this Agreement by each Partner, each Partner hereby waives, relinquishes, and renounces any such right or claim of participation.

(c) To the extent permitted by applicable law and except as otherwise provided in this Agreement, each General Partner, when acting on behalf of the Partnership is hereby authorized to purchase property from, sell property to, or otherwise deal with any Partner, acting on its own behalf, or any Affiliate of any Partner, provided that any such purchase, sale or other transaction shall be made on terms and conditions which are no less favorable to the Partnership than if the sale, purchase, or other transaction had been entered into with an independent third party.

1.10. DEFINITIONS. Capitalized words and phrases used in this Agreement have the following meanings:

(a) "Accepting Offerees" has the meaning set forth in Section 10.4(d) hereof.

(b) "Act" means the California Revised Limited Partnership Act, as amended from time to time (or any corresponding provisions of succeeding law).

(c) "Adjusted Capital Account deficit" means, with respect to any Interest Holder, the deficit balance, if any, in such Interest Holder's Capital Account

as of the end of the relevant Fiscal Year, after giving effect to the following adjustments:

-3-

(i) Credit to such Capital Account amounts which such Interest Holder is obligated to restore pursuant to any provision of this Account or is deemed to be obligated to restore pursuant to the penultimate sentences of Regulations Sections 1.704.2(g)(5) and 1.704.2(i)5; and

(ii) Debit to such Capital Account the items described in Sections 1.74-1(b)(2)(ii)(d)(4), 1.7-l(b)(2)(ii)(d)(5) and 1.704-1(b)(2)(ii)(d)(6) of the Regulations.

The foregoing definition of Adjusted Capital Account Deficit is intended to comply with the provisions of Section 1.704-1(b)(2)(11)(d) of the Regulations and shall be interpreted consistently therewith,

(d) "Adjusted Capital Contributions" means, as of any day, an Interest Holder's Capital Contributions adjusted as follows:

(i) Increased by the amount of any Partnership liabilities which, in connection with

distributions pursuant to Sections 4.2(a) and 13.2(d) hereof are assumed by such Interest Holder or are secured by any Partnership Property distributed to such Interest Holder;

(ii) Increased by any amounts actually paid by such Interest Holder to any Partnership lender pursuant to the terms of any Assumption Agreement; and

(iii) Reduced by the amount of cash and the Gross Asset Value of any. Partnership Property distributed to such Interest Holder pursuant to Sections 4.2(a) and 13.2(d) hereof and the amount of any liabilities of such Interest Holder assumed by the Partnership of which are secured by any property contributed by such Interest Holder to the Partnership.

In the event any Interest Holder transfers all or any portion of his Interest in accordance with the terms of this Agreement, his transferee shall succeed to the Adjusted Capital Contribution of the transferee to the extent it relates to the transferred Interest.

(e) "Affiliate" means, with respect to any Person, (1) any Person directly or indirectly controlling, controlled by or under common control with such Person, (ii) any Person owning or controlling ten percent (10%) or more of the outstanding voting interests of such Person,

(iii) any officer, director, or general partner of such Person, or (iv) any Person who is an officer, director, general partner, trustee, or holder of ten percent (10%) or more of the voting interests of any Person described in clauses (i) through (iii) of this sentence. For purposes of this definition, the term "controls," "is controlled by," or "is under common control with" shall mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person or entity either through ownership of _____ securities, by contract or otherwise.

(f) "Agreement" or "Partnership" means this Agreement of Limited Partnership, as amended from time to time. Words such as "herein," "hereinafter," "hereof," "hereto," and "hereunder," refer to this Agreement as a whole, unless the -context otherwise requires.

(g) "Assumption Agreement" means any agreement among the Partnership any of the Partners, and any Person to whom the Partnership is indebted pursuant to a loan agreement, any seller financing with respect to an installment sale, a reimbursement agreement, or any other arrangement (collectively referred to as a "loan" for purposes of this Agreement) pursuant to which any Partner expressly assumes any personal liability with respect to

such loan. The amount of any such loan shall be treated as assumed by the Partners for all purposes under this Agreement in the proportions set forth in such Assumption Agreement and their respective amounts so assumed shall be credited to their respective Capital Accounts pursuant to Section 1.10)(j)(i) hereof. To the extent such loan is repaid by the Partnership. the Partners' Capital Accounts shall be debited with their respective shares of the repayments pursuant to Section 1.10)(j)(ii) hereof. To the extent such loan is repaid by some or all of the Partners from their own funds, there shall be no adjustments to their Capital Accounts.

(h) "Bankruptcy" means, with respect to any Person, a "Voluntary Bankruptcy," or an "Involuntary Bankruptcy." A "Voluntary Bankruptcy" means. with respect to any Person, the inability of such Person generally to pay its debts as such debts become due, or an admission in writing by such Person of its inability to pay its debts generally or a general assignment by such Person for the benefit of creditors; the filing of any petition or answer by such Person seeking to adjudicate it a bankrupt or insolvent; or seeking for itself any liquidation, winding up, reorganization, arrangement. adjustment, protection, relief, or composition of such Person or its debts under any law relating to bankruptcy, insolvency or reorganization or relief of debtors, or seeking, consenting to, or acquiescing in the entry of an order for relief or the appointment of a

receiver, trustee, custodian or other similar official for such Person or for any substantial part of its property; or corporate action taken by such Person to authorize any of the actions set forth above. An "Involuntary Bankruptcy" means, with respect to any Person, without the consent or acquiescence of such Person, the entering of an order for relief or approving a petition for relief or reorganization or any other petition seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or other similar relief under any present or future bankruptcy, insolvency or similar statute, law or regulation, or the filing of any such petition against such Person which petition shall not be dismissed within ninety (90) days, or, without the consent or acquiescence of such Person, the entering of an order appointing a trustee, custodian, receiver, or liquidator of such Person or of all or any substantial part of the property of such Person which order shall not be dismissed within sixty (60) days.

(i) "Business Day" means day of the Year on which banks are not required or authorized to close in Los Angeles.

(j) "Capital Account" means, with respect to any General Partner or Interest Holder, the Capital

Account maintained for such Person in accordance with the following provisions;

(i) To each Person's Capital Account there shall be credited such Person's Capital Contributions, such Person's distributive share of Profits and any items in the nature of income or gain which are specialty allocated pursuant to Section 3.3 or Section 3.4 hereof, and the amount of any Partnership liabilities assumed by such Person or which are secured by any Property distributed to such Person.

(ii) To each Person's Capital Account there shall be debited amount of cash and the Gross Asset Value of any Property distributed to such Person pursuant to any provision of this Agreement, such Person's distributive share of Losses and any items in the nature of expenses or losses which are specialty allocated pursuant to Section 3.3 or Section 3.4 hereof, and the amount of any liabilities of such Person assumed by the Partnership or which are secured by any property contributed by such Person to the Partnership.

(iii) In the event all or a portion of an interest in the Partnership is transferred in accordance with the terms of this Agreement, the transferee shall succeed to the Capital Account of the transferee to the content it relates to the transferred interest.

(iv) In determining the amount of any liability for purposes of Sections 1.10(d)(iii), 1.10(j)(i) and 1.10(j)(ii) hereof, there shall be taken into account Code Section 752(c) and any other applicable provisions of the Code and Regulations.

The foregoing provisions and the other provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Regulations Section 1.704-1(b), and shall be interpreted and applied in a manner consistent with such Regulations. In the event the General Partner shall determine that it is prudent to modify the manner in which the Capital Accounts, or any debits or credits thereto (including, without limitation, debits or credits relating to liabilities which are secured by contributions or distributed property or which are assumed by the Partnership, General Partner, or Interest Holder), are computed in order to comply with such Regulations, the General Partner may make such modification, provided that it is not likely to have a material effect on the amounts distributed to any Person pursuant to Section 13 hereof upon the dissolution of the Partnership. The General Partner also shall (i) make any adjustments that are necessary or appropriate to maintain equality between the Capital Accounts of the General Partner and Interest Holders and the

amount of Partnership capital ref_____ on the Partnership's balance sheet as computed for book purposes in accordance with Regulations Section 1.704-1(b)(2)(iv)(g), and (ii) make any appropriate modifications in the event unanticipated events (for example the acquisition by the Partnership of oil or gas properties) might otherwise cause this Agreement not to comply with Regulations Section 1.704-1(b).

(k) "Capital Contributions" means, with respect. to any General Partner or Interest Holder, the amount of money and the initial Gross Asset Value of any property (other than money) contributed to the Partnership with respect to the interest in the Partnership held by such Person. The principal amount of a promissory note which is not readily traded on an established securities market and which is contributed to the Partnership by the maker of the note (or a Person related to the maker of the note within the meaning of Regulations Section 1.704-1(b)(2)(ii)(c)) shall not be included in the Capital Account of any Person until the Partnership makes a taxable disposition of the note or until (and to the extent) principal payments are made on the note, all in accordance with Regulations Section 1.704-1(b)(2)(iv)(d)(2).

(l) "Certificate" has the meaning set forth in Section 1.5 hereof.

(m) "Code" means the Internal Revenue Code of 1986, as amended from time to time (or any corresponding provisions of succeeding law).

(n) "'Debt" means (i) any indebtedness for borrowed money or deferred purchase price of property or or evidenced by a note, bonds, or other instruments, (ii) obligations as lessee under capital leases, (iii) obligations secured by any mortgage, pledge, security interest, encumbrance. lien or charge of any kind existing on any asset owned or held by the Partnership whether or not the Partnership has assumed or become liable for the obligations secured thereby, (iv) any obligation under any interest rate swap agreement (the principal amount of such obligation shall be deemed to be the notional principal amount on which such swap is based), and (v) obligations under direct or indirect guarantees of (including obligations (contingent or otherwise) to assure a creditor against loss in respect of) indebtedness or obligations of the kinds referred to in clauses (i), (ii), (iii) and (iv) above, provided that Debt shall not include obligations in respect of any accounts payable that are incurred in the ordinary course of the Partnership's business and are not delinquent or are being contested in good faith by appropriate proceedings.

(o) "Depreciation" means, for each Fiscal Year, an amount equal to the depreciation, amortization, or

other cost recovery deduction allowable with respect to an asset for such Fiscal Year, except that if the Gross Asset Value of an asset differs from its adjusted basis for federal income tax purposes at the beginning of such Fiscal Year, Depreciation shall be an amount which bears the same ratio to such beginning Gross Asset Value as the federal income tax depreciation, amortization, or other cost recovery deduction for such Fiscal Year bears to such beginning adjusted tax basis; provided, however, that if the adjusted basis for federal income tax purposes of an asset

at the beginning of such Fiscal Year is zero, Depreciation shall be determined with reference to such beginning Gross Asset Value using any reasonable method selected by the General Partner.

(p) [omittedl

(q) "Family" has the meaning set forth in Section 10.2 hereof.

(r) "Firm Offer" shall have the meaning set forth in Section 10.4(b) hereof.

(s) "Fiscal Year" means (i) the period commencing on the effective date of this Agreement and

ending on December 31, (ii) any subsequent twelve (12) month period commencing on January 1 and ending on December 31, or (iii) any portion of the period described in clause (ii) for which the Partnership is required to allocate Profits, Losses and other items of Partnership income, gain, loss or deduction pursuant to Section 3 hereof.

(t) "General Partner" means any Person who (i) is referred to as such in the first paragraph of this Agreement or has become a General Partner pursuant to the terms of this Agreement, and (ii) has not ceased to be a General Partner pursuant to the terms of this Agreement. "General Partners" means all such Persons.

(u) "Gross Asset Value" means, with respect to any asset, the assets adjusted basis for federal income tax purposes, except (as follows:

(i) The initial Gross Asset Value of any asset contributed by a Partner to the Partnership shall be the gross fair market value of such asset, as determined by the contributing Partner and the General Partner, provided that, if the contributing Partner is a General Partner, the determination of the fair market value of a contributed asset shall require the consent of a majority of the Limited Partners;

(ii) The Gross Asset Values of all Partnership assets shall be adjusted to equal their respective gross fair market values, as determined by the General Partner, as of the following times: (a) the acquisition of an additional interest in the Partnership by any new or existing Partner in exchange for more than a *de minimis* Capital Contribution; (b) the distribution by the Partnership to a General Partner or Interest Holder of more than a *de minimis* amount of Property as consideration for an interest in the Partnership and (c) the liquidation of the Partnership within the meaning of Regulations Section 1.704-1(b)(2)(ii)(g): provided, however, that adjustments pursuant to clauses (a) and (b) above shall be made only if the General Partner reasonably determines that such adjustments are necessary or appropriate to reflect the relative economic interests of the General Partner and Interest Holders in the Partnership;

(iii) The Gross Asset Value of any Partnership asset distributed to any General Partner or Interest Holder shall be adjusted to equal the gross fair market value of such asset on the date of distribution as determined by the distributee and the General Partner, provided that, if the distributee is a General Partner, determination of the fair market value of the distributed

asset shall require the consent of a majority of the Limited Partners; and

(iv) The Gross Asset Values of Partnership assets shall be increased (or decreased) to reflect any adjustments to the adjusted basis of such assets pursuant to Code Section 734(b) or Code Section 743(b), but only to the extent that such adjustments are taken into account in determining Capital Accounts pursuant to Regulation Section 1.704(b)(2)(iv)(m) and Sections 1.10(au)(vi) and 3.3(g) hereof; provided, however, that Gross Asset Values shall not be adjusted pursuant to this Section 1.10(u)(iv) to the extent the General Partner determine(s) that an adjustment pursuant to Section 1.10(u)(ii) hereof is necessary or appropriate in connection with a transaction that would otherwise result in an adjustment pursuant to this Section 1.10(u)(iv).

If the Gross Asset Value of an asset has been determined or adjusted pursuant to Section 1.10(u)(i), Section 1.10(u)(ii), or Section 1.10(u)(iv) hereof, such Gross Asset Value shall thereafter be adjusted by the Depreciation taken into account with respect to such asset for purposes of computing Profits and Losses.

(v) "Interest" means an ownership interest in the Partnership representing a Capital Contribution by a Limited Partner pursuant to Section 2.2 hereof, including

any and all benefits to which the holder of such an Interest may be entitled as provided in this Agreement, together with all obligations of such. Person to comply with the terms and provisions of this Agreement.

(w) "Interest Holder" means any Person who holds an interest. regardless of whether such Person has been admitted to the Partnership as a Limited Partner. "Interest Holders" means all such Persons.

(x) "Involuntary Bankruptcy" has the meaning set forth in Section 1.10(h) hereof:

(y) "Issuance terms" has the meaning set forth in Section 3.3(i) hereof:

(z) "License Agreement" shall mean that certain License Agreement between Jeanne Piaubert S.A., a French corporation and the Partnership, as such may be amended from time to time.

(aa) "Limited Partners means any Person (i) whose name is set forth as such on Exhibit A attached hereto or who has become a Limited Partner pursuant to the terms of this Agreement, and (ii) who holds an Interest, "Limited Partners"

means all such Persons. All referenced in this Agreement to a majority or a specified percentage of the Limited Partners shall mean Limited Partners whose combined Interests represent more than fifty percent (50%) of such specified percentage respectively, of the Interests then held by all Limited Partners.

(a b) "Liquidating Event" has the meaning set forth in Section 13.1 hereof.

(ac) "Net Cash From Operations" means the gross cash proceeds from Partnership operations (including sales and dispositions of Property in the ordinary course of business) less the portion thereof used to pay or establish reserves for all Partnership expenses, debt payments, capital improvements, replacements, and contingencies, all as determined by the General Partner. "Net Cash From Operations" shall not be reduced by depreciation, amortization, cost recovery deductions, or similar allowances, but shall be "increased by any reductions of reserves previously established pursuant to the first sentence of this Section 1.10(ac) and Section 1.10(ad) hereof.

(ad) "Net Cash From Sales or Refinancings" means the net cash proceeds from all sales and other dispositions (other than in the ordinary course of business) and all refinancings of Property, less any portion thereof

used to establish reserves, all as determined by the General Partner. "Net Cash From Sales or Refinancings" shall include all principal and interest payments with respect to any note or other obligation received by the Partnership in connection with sales and other dispositions (other than in the ordinary course of business) of Property.

(ae) "Nonrecourse Deductions" has the meaning set forth in Section 1.704-2(b)(1) of the Regulations.

(af) "Nonrecourse Liability" has the meaning set f orth in Section 1.704-2(b)(3) of the Regulations.

(ag) "Offer Notice" has the meaning set forth in Section 10.4(b) hereof.

(ah) "Offer Period" has the meaning set forth in Section 10.4(c) hereof.

(ai) "Offer Price" has the meaning set forth in Section 10.4 hereof.

(aj) "Offered Interests" has the meaning set forth in Section 10.4 hereof.

(ak) "Offerees" has the meaning set forth in Section 10.4(b) hereof.

(ai) "Partner Nonrecourse Debt" has the meaning set forth in Section 1.704-2(b)(4) of the Regulations.

(am) "Partner Nonrecourse Debt Minimum Gain" means an amount, with respect to each Partner Nonrecourse Debt. equal to the Partnership Minimum Gain that would result if such Partner Nonrecourse Debt were treated as a Nonrecourse Liability, determined in accordance with Section 1.70-4.2(i)(3) of the Regulations.

(an) "Partner Nonrecourse Deductions" has the meaning set forth in Sections 1.704(i)(1) and 1.704-2(i)(2) of the Regulations.

(ao) "Partners means all General Partners and all Limited Partners, where no distinction is required by the context in which the term is used herein. "Partner" means any one of the Partners. All referenced in this Agreement to a majority or a specified percentage of the Partners shall mean Partners who are entitled to receive more than fifty percent (50%) or such specified percentage, respectively, of any distributions pursuant to Section 4.1(b) hereof.

(ap) "Partnership" means the partnership formed pursuant to this Agreement and the partnership continuing the business of this Partnership in the event of dissolution as herein provided.

(aq) "Partnership Minimum Gain" has the meaning set forth in Sections 1.704-2(b)(2) and 1.704-2(d) of the Regulations.

(ar) "Permitted Transfer" has the meaning set forth in Section 10.2 hereof.

(as) "Person" means any individual, partnership, corporation, trust or other entity.

(at) [omitted]

(au) "Profits" and "Losses" means, for each Fiscal Year, an amount equal to the Partnership's taxable income or less for such Fiscal Year, determined in accordance Code Section 703(a) (for this purpose, all Items of income, gain, loss, or deduction required to be stated separately pursuant to Code Section 703(a)(1) shall be included in taxable income or loss), with the following adjustments:

(i) Any income of the Partnership that is exempt from federal income tax and not otherwise

taken into account in computing Profits or Losses pursuant to this Section 1.10(au) shall be added to such taxable income or loss;

(ii) Any expenditures of the Partnership described in Code Section 705(a)(2)(B) or treated as Code Section 705(a)(2)(B) expenditures pursuant to Regulations Section 1.704-1(b)(2)(iv)(i), and not otherwise taken into account in computing Profits or Losses pursuant to this Section 1.10(au) shall be subtracted from such taxable income or loss;

(iii) In the event the Gross Asset Value of any Partnership asset is adjusted pursuant to Section 1.10(u)(ii) or Section 1.10(u)(iii) hereof. the amount of such adjustment shall be taken into account as gain or loss from the disposition of such asset for purposes of computing Profits or Losses;

(iv) Gain or loss resulting any disposition of Property with respect to which gain or loss is recognized for federal income tax purposes shall be computed by reference to the Gross Asset Value of the property disposed of, notwithstanding that the adjusted basis of such property differs from its Gross Asset Value;

(v) In lieu of the depreciation, recovery amortization and other cost recovery deductions taken into account in computing such taxable income or loss, there shall be taken into account Depreciation for such Fiscal Year, computed in accordance , with Section 1.10(o) hereof;

(vi) To the extent an adjustment to the adjusted tax basis of any Partnership asset pursuant to Code Section 734(b) or Code Section 743(b) is required pursuant to Regulations Section 1.704-1(b)(2)(iv)(m)(4) to be taken into account in determining Capital Accounts as a result of a distribution other than in complete liquidation of a Partner's or Interest Holder's Interest, the amount of such adjustment shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases the basis of the asset) from the disposition of the asset and shall be taken into account for purposes of computing Profits or Losses: and

(vii) Not withstanding any other provision of this Section 1.10(au), any items which are specifically allocated pursuant to Section 3.3 or Section 3.4 hereof shall not be taken into account in computing Profits or Losses.

The amounts of the items of Partnership income, gain, loss or deduction available to be specially allocated pursuant to

Sections 3.3 and 3.4 hereof shall be determined by applying rules analogous to those set forth in Sections 1.10(au)(1) through 1.10(au)(vi) above.

(av) "Property" means all real, personal and intangible property acquired by the Partnership and any improvements thereto, and shall include both tangible and intangible property.

(aw) "Purchase Offer" has the meaning set forth in Section10.4(a) hereof.

(ax) "Purchaser" has the meaning set forth in Section 10.4(a) hereof.

(ay) "Reconstruction Period" has the meaning set forth in Section 13.1 hereof.

(az) "Regulations" means the Income Tax Regulations, including Temporary Regulations, promulgated under the Code,, as such regulations may be amended from time to time (including corresponding provisions of succeeding regulations).

(ba) "Regulatory Allocations has the meaning set forth in Section 3.4 hereof.

(bb) "Seller" has the meaning set forth in Section 10.4 hereof.

(bc) "Tax Maters Partner has the meaning set forth In Section 5.1(j) hereof.

(bd) "Transfer" means, as a noun, any voluntary or involuntary transfer, sale, or other disposition and, as a verb, voluntarily or involuntarily to transfer, sell or otherwise dispose of.

(be) "Voluntary Bankruptcy", has the meaning set forth in Section 1.10(h) hereof.

(bf) "Wholly Owned Affiliate" of any Person means an Affiliate of such of such Person (i) one hundred percent (100 %) of tho voting stock or beneficial ownership of which is owned directly by such Person, or by any Person who, directly or indirectly, owns one hundred percent (100%) of the voting stock or beneficial ownership of such Person, (ii) an Affiliate of such Person who, directly or indirectly owns one hundred percent (100%) of the voting stock or beneficial ownership of such Person, and (iiii) any Wholly Owned Affiliate of any Affiliate described in clause (i) or clause (ii) of this Section 1.10(bf).

Section 2

PARTNER'S CAPITAL CONTRIBUTIONS

2.1. GENERAL PARTNER. The name, address, and Capital Contribution of General Partner is as follows:

Name and Address	Capital Contribution
Jeanne Piaubert Management, Inc. 1901 Avenue of the Stars Suite 1100 Los Angeles, CA 90067	Set forth on Exhibit A

2.2. LIMITED PARTNERS. The names, addresses, Capital Contributions, and Interests of the Limited Partners are set forth on Exhibit A attached hereto.

2.3. OTHER MATTERS.

(a) Except as otherwise provided in this Agreement, no General Partner or Interest Holder shall demand or receive a return of his Capital Contributions or withdraw from the Partnership without the consent of all Partners. Under circumstances requiring a return of any

Capital Contributions, no General Partner or Limited Holder shall have the right to receive property other than cash except as may be specifically provided herein.

(b) No General Partner or Interest Holder shall receive any interest, salary or drawing with respect to his Capital Contributions or his Capital Account or for services rendered on behalf of the Partnership or otherwise in his capacity as a General Partner or Interest Holder , except as otherwise provided in this Agreement or pursuant to written agreements among the Partners.

(c) Provided that the Limited Partners act in accordance with this Agreement and except as otherwise provided by an Assumption Agreement. no Limited Partner shall be liable for the debts, liabilities, contracts, or any other obligations of the Partnership. Except as otherwise provided by any other agreements among the Partners or mandatory provisions of applicable state law, a Limited Partner shall be liable only to make his Capital Contributions and shall not be required to lend any funds to the Partnership or, after his Capital Contributions have been made, to make any additional Capital Contributions to the Partnership.

(d) No General Partner shall have any personal liability for the repayment of any Capital Contributions of any Interest Holder.

Section 3
ALLOCATIONS

3.1. PROFITS. After giving effect to the special allocations set forth in Sections 3.3 and 3.4 hereof, Profits for any Fiscal Year shall be allocated ninety-nine percent (99%) to the Interest Holders and one percent (1%) to the General Partner.

3.2. LOSSES. After giving effect to the special allocations set forth in Sections 3.3 and 3.4 hereof, Losses for any Fiscal Year shall be allocated as set forth in Section 3.2(a) below, subject to the limitation in Section 3.2(b) below.

(a) Losses for any Fiscal Year shall be allocated ninety-nine percent (99%) to the Interest Holders and one percent (1%) to the General Partner.

(b) The Losses allocated pursuant to Section 3.2(a) hereof shall not exceed the maximum amount of Losses that can be so allocated without causing any Interest Holder to have an Adjusted Capital Account Deficit at the end of any Fiscal Year. In the event some but not all of the Interest Holders would have Adjusted Capital Account Deficits as a consequence of an auction of

Losses pursuant to Section 3.2(a) hereof, the Limitation set forth in this Section 3.2(b) shall be applied on an Interest Holder by Interest Holder basis so as to allocate the maximum permissible Losses to each Interest Holder under Section 1.704-1(b)(2)(ii)(d) of the Regulations. All Losses in excess of the limitations set force in this Section 3.2(b) shall be allocated to the General Partner.

3-3. SPECIAL ALLOCATIONS. The following special allocations shall be made in the following order:

(a) Minimum Gain Chargeback. Except as otherwise provided in Section 1.704-2(f) of the Regulations, notwithstanding any other provision of this Section 3, if there is a net decrease in Partnership Minimum Gain during any Fiscal Year, each General Partner and Interest Holder shall be specially allocated items of Partnership income and gain for such Fiscal Year (and. if necessary, subsequent Fiscal Years) in an amount equal to such Person's share of the net decrease In Partnership Minimum Gain, determined in accordance with Regulations Section 1.704.2(g). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each General Partner and Interest Holder pursuant thereto. The items to be so allocated shall be determined in accordance with Sections 1.704-2(f)(6) and 1.704-2(j)(2) of the

Regulations. This Section 3.3(a) is intended to comply with the minimum gain chargeback requirement in Section 1.704-2(f) of the Regulations and shall be interpreted consistently therewith.

(b) Partner Minimum Gain Chargeback. Except as otherwise provided in Section 1.704-2(i)(4) of the Regulations, notwithstanding any other provision of this Section 3, if there is net decrease in Partner Nonrecourse Debt Minimum Gain attributable to a Partner, Nonrecourse Debt during any Partnership Fiscal Year, each Person who has a share of the Partner Nonrecourse Debt Minimum Gain attributable to such Partner Nonrecourse Debt, determined in accordance with Section 1.704-2(i)(5) of the Regulations, shall be specially allocated items of Partnership income and gain for such Fiscal Year (and, if necessary, subsequent Fiscal Years) in an amount equal to such Person's share of the net decrease in Partner Nonrecourse Debt Minimum Gain attributable to such Partner Nonrecourse Debt, determined in accordance with Regulations Section 1.704-2(i)(4). Allocations pursuant to the previous sentence shall be made in proportion to the respective amounts required to be allocated to each General Partner and Interest Holder pursuant thereto. The items to be so allocated shall be determined in accordance with Sections 1.704-2(i)(4) and 1.704-2(j)(2) of the Regulations. This Section 3.3(b) is intended to comply with the minimum gain

chargeback requirement in Section 1.704-2(i)(4) of the Regulations and shall be interpreted consistently therewith.

(c) Qualified Income Offset. In the event any Interest Holder unexpectedly receives any adjustments, allocations, or distributions described in Section 1.704-1 (b)(2)(ii)(d)(4), Section 1.704-1(b)(2)(ii)(d)(5) or Section 1.704-1 (b)(2)(ii)(d)(6) of the Regulations, items of Partnership income and gain shall be specially allocated to each such Interest Holder in an amount and manner sufficient to eliminate, to the extent required by the Regulators, the Adjusted Capital Account Deficit of such Interest Holder as quickly as Possible, provided that an allocation pursuant to this Section 3.3(c) shall be made only if and to the extent that such Interest Holder would have an Adjusted Capital Account Deficit after all other auctions provided for in this Section 3 have been tentatively made as if this Section 3.3(c) were not in the Agreement.

(d) Gross Income Allocation. In the event any Interest Holder has a deficit Capital Account at the end of any Partnership Fiscal Year which is in excess or the sum of (i) the amount such Interest Holder is obligated to restore pursuant to any provision of this Agreement, and (ii) the amount such Interest Holder is deemed to be

obligated to restore pursuant to the penultimate sentences of Regulations Sections 1.704-2(g)(1) and 1.704-2(i)(5), each such Interest Holder shall be specially allocated items of Partnership income and gain in the amount of such excess as quickly as possible, provided that in an allocation pursuant to this Section 3.3(d) shall be made only if and to the to the extent that such Interest Holder would have a deficit Capital Account in excess of such sum after all other allocations provided for in this Section 3 have been made as if Section 3.3(c) hereof and this Section 3.3(d) were not in the Agreement.

(e) Nonrecourse Deductions. Nonrecourse Deductions for any Fiscal Year specifically allocated one percent (1%) to the General Partner and ninety-nine percent (99%) to the Interest Holders.

(f) Partner Nonrecourse Deductions. Any Partner Nonrecourse Deductions for any Fiscal Year shall be specialty allocated to the General Partner or Interest Holder who bears the economic risk of loss with respect to the Partner Nonrecourse Debt to which such Partner Nonrecourse Deductions are attributable in accordance with Regulations Section 1.704.2(i)(1).

(g) Section 754 Adjustments. To the extent an adjustment to the adjusted tax basis of any Partnership asset pursuant to Code Section 734(b) or Code Section

743(b) is required, pursuant to Regulations Section 1.704-1(b)(2)(iv)(m)(2) or Regulations Section 1.704-1(b)(2)(iv)(m)(4), to be taken into account in determining Capital Accounts as the result of a distribution to a General Partner or Interest Holder in complete liquidation of his interest in the Partnership, the amount of such adjustment to Capital Accounts shall be treated as an item of gain (if the adjustment increases the basis of the asset) or loss (if the adjustment decreases such basis) and

such gain or loss shall be specially allocated to the General Partner and the Interest Holders in accordance with their interests in the Partnership in the event that Regulations Section 1.704-1(b)(2)(iv)(m)(4) applies, or to the General Partner or Interest Holder to whom such distribution was made in the event that Regulations 1.704-1(b)(2)(iv)(m)(4) applies.

(h) Priority Return Allocations. All or a portion of the remaining items of Partnership income or gain, if any, shall be specially allocated to the General Partner and Interest Holders in proportion to and to the extent of the excess, if any, of (i) the cumulative Priority Return distributions each such General Partner and Interest Holder has received pursuant to Section 4.1(a), 4.2(b) and 13.2(c) hereof from the commencement of the Partnership

to a date thirty (30) days after the end of such Fiscal Year, over (ii) the cumulative items of income and gain allocated to such General Partner or Interest Holder pursuant to this Section 3.3(h) for all prior Fiscal Years.

(i) Allocations Relating to Taxable Issuance or Partnership Interests. Any income. gain, loss or deduction realized as a direct or indirect result of the issuance of an interest by the Partnership to a Partner (the "Issuance Items") shall be allocated among the General Partner and Interest Holders so that, to the extent possible, the net amount of such Issuance Items, together with all other allocations under this Agreement to each General Partner and Interest Holder, shall be equal to the net amount (that would have been allocated to each such General Partner and Interest Holder if the Issuance Items had not been realized.

3.4. Curative Allocations. The allocations set forth in Sections 3.2(b), 3.3(a), 3.3(b), 3.3(c), 3.3(d), 3.3(e), 3.3(f) and 3.3(g) hereof (the "Regulatory Allocations") are intended to comply with certain requirements of the Regulations. It is the intent of the Partners that to the extent possible, all Regulatory Allocations shall be offset either other Regulatory Allocations or with special allocations of other Items of Partnership income, gain, loss or deduction pursuant to this Section 3.4. Therefore, notwithstanding any other provision of this Section 3

(other than the Regulatory Allocations), the General Partner shall make such offsetting special allocations of Partnership income, gain, loss or deduction in whatever manner it [they] determine(s] appropriate so that, after such offsetting allocations are made, each General Partner's and Interest Holder's Capital Account balance is, to the extent possible, equal to the Capital Account balance such General Partner or Interest Holder would have had if the Regulatory Allocations were not part of the Agreement and all Partnership items were allocated pursuant to Sections 3.1, 3.2(a), and 3.3(h). In exercising its discretion under this Section 3.4, the General Partner shall take into account future Regulatory Allocations under Sections 3.3(a) and 3.3(b) that, although not yet made, are likely to offset other Regulatory Allocations previously made under Sections 3.3(c) and 3.3(f).

3.5. Other Allocation Rules.

(a) For purposes of determining the Profits, Losses or any other items allocable to any period, Profits, losses, and any such other items shall be determined on a daily, monthly, or other basis, as determined by the General Partner using any permissible Method under Code Section 706 and the Regulations thereunder.

(b) All allocations to the Interest Holders pursuant to this Section 3 shall, except as otherwise provided, be divided among them in the proportion to the Interests held by each. In the event there is more than one General Partner, all such allocations to the General Partner shall be divided among them as they may agree.

(c) The Partners are aware of the income consequences of the allocations made by this Section 3 and hereby agree to be bound by the provisions of this Section in reporting their shares of Partnership income and loss for income tax purposes.

(d) Solely for purposes of determining a Partner's or Interest Holder's proportionate share of the "excess nonrecourse liabilities" of the Partnership within the meaning of Regulations Section 1.752-3(a)(3), the Partners' and Interest Holders' interests in Partnership profits are as follows: General Partner one percent (1%), and Interest Holders ninety-nine percent (99%) (in proportion to their Interests).

(e) To the extent permitted by Section 1.704-2 (h)(3) of the Regulations, the General Partner shall endeavor to treat distributions of Net Cash From Operations or Net Cash From Sales or Refinancings as having been made from the proceeds of a Nonrecourse Liability or a Partner Nonrecourse Debt only to the extent that such distributions would cause or increase an Adjusted Capital Account Deficit for any Interest Holder.

3.6. TAX ALLOCATIONS: CODE SECTION 704(c). In accordance with Code Section 704(c) and the Regulations thereunder, income, gain, loss, and deduction with respect to any property contributed to the capital of the Partnership shall, solely for tax purposes, be allocated among the General Partner and Interest Holders so as to take account of any variation between the adjusted basis of such property to the Partnership for federal income tax purposes and its initial Gross Asset Value (computed in accordance with Section 1.10(u)(i) hereof.

In the event the Gross Asset Value of any Partnership asset is adjusted pursuant to Section 1.10(u)(ii) hereof, subsequent allocations of income, gain, loss, and deduction with respect to such asset shall take account of any variation between the adjusted basis of such asset for federal income tax purposes and its Gross Asset Value in the same manner as under Code Section 704(c) and the Regulations thereunder.

Any elections or other decisions relating to such allocations shall be made by the General Partner any manner that reasonably reflects the purpose and intention of this Agreement. Allocations pursuant to this Section 3.6 are solely for purposes of federal, state, and local taxes and shall not affect, or in any way be taken into account in

computing , any Person's Capital Account or share of Profits, Losses, other items, or distributions pursuant to any provision of this Agreement.

Section 4
DISTRIBUTIONS

4.1. NET CASH FROM OPERATIONS. Except as otherwise provided in Section 13 hereof, Net Cash From Operations, if any, shall be distributed not later than the 30th day after the end of each fiscal quarter one percent (1%) to the General Partner, and ninety-nine percent (99%) to the Interest Holders.

4.2. NET CASH FROM SALES OR REFINANCINGS. Except as otherwise provided in Section 13 hereof, Net Cash From Sales or Refinancings shall be distributed, at such times as the General Partner may determine, one percent (1%) to the General Partner and ninety-nine percent (99%) to the Interest Holders.

4-3. DIVISION AMONG INTEREST HOLDERS AND GENERAL PARTNERS. All distributions to the Interest Holders pursuant to this Section 4 shall be divided among them in proportion to the Interests held by each. In the event there is more than one General Partner, all amounts distributed to the General Partners pursuant to

this Section 4 shall be dividend among them as they may agree.

4.4. AMOUNTS WITHHELD. All amounts withhold pursuant to the Code or any provision of any state or local tax law with respect to any payment. distribution or allocation to the Partnership, the General Partner or the Interest Holders shall be treated as amounts distributed to the General Partner and the Interest Holders pursuant to this Section 4 for all purposes under this Agreement. The General Partner is authorized to withhold from distributions, or with respect to allocations, to the General Partner and Interest Holders and to pay over to any federal, state or local government any amounts required to be so withheld pursuant to the Code or any provisions of any other federal, state or local law and shall allocate any such amounts to the General Partner and Interest Holders with respect to which such amount was withheld.

MANAGEMENT

5.1. AUTHORITY OF THE GENERAL PARTNER. Subject to the limitations and restrictions set forth in this Agreement (including, without limitation, those set forth in this Section 5) the General Partner shall have the sole and exclusive

right to manage the business of the Partnership and shall have all of the rights and powers which may be possessed by general partners under the Act including, without limitation, the right and power to:

(a) Acquire by purchase, lease , or otherwise any real or personal property which may be necessary, convenient, or incidental to the accomplishment of the purposes of the Partnership;

(b) Operate, maintain, finance, improve, construct, own, grant options with respect to, sell, convey, assign, mortgage, and lease any real, personal or intangible property necessary, convenient, or incidental to the accomplishment of the purposes of the Partnership;

(c) Execute any and all agreements, contracts, documents, certifications, and instrumentals necessary or convenient in connection with the management, maintenance, and operation of Property, or in connection with managing the affairs of the Partnership, including executing amendments to the Agreement and the Certificate in accordance with the terms of the Agreement, both as General Partner and, if required, as attorney[s]-in-fact for the Limited Partners pursuant to any power of

attorney granted by the Limited Partners to the General Partner;

(d) Borrow money and issue evidences of indebtedness necessary, or incidental to the accomplishment of the purposes of the Partnership, and secure the same by mortgage, pledge, or other lien on any Property;

(e) Execute, in furtherance of any or all of the purposes of the Partnership, any deed, lease, mortgage, deed of trust, mortgage note, promissory note. bill of sale, contract, license, franchise agreement, distribution agreement or other instrument purporting to convey or encumber all or any part of any Property.

(f) Prepay in whole or in part, refinance. recast, increase, modify, or extend any liabilities affecting any Property and in connection therewith execute any extensions or renewals of encumbrances on any or all Property;

(g) Care for and distribute funds to the General Partner and Interest Holder by way of cash, income, return of capital, or otherwise, all in accordance with the provisions of this Agreement, and perform all matters in furtherance of the objectives of the Partnership or this Agreement;

(h) Contract on behalf of the Partnership for the employment and services of employees and/or independent contractors, such as lawyers and accountants, and delegate to such Persons the duty to manage or supervise any of the assets or operations of the Partnership;

(i) Engage in any kind of activity and perform and carry out contracts of any kind (including contracts of insurance covering risks to Property and General Partner liability) necessary or incidental to, or in connection with the accomplishment of the purposes of the Partnership, as may be lawfully carried on or performed by a partnership under the laws of each scale in which the Partnership is then formed or qualified;

(j) Make any and all elections for federal, state, and local tax purposes including, without limitation, any election, if permitted by applicable law: (i) to adjust the basis of Property pursuant to Code Sections 754,734(b), and 743(b), or comparable provisions of state or local law, in connection with transfer of interests in the Partnership and Partnership distributions; (ii) with the consent of a majority of the Limited Partners, to extend the statute of limitations for assessment of tax deficiencies against General Partners and Interest Holders with respect

to adjustments to the Partnership's federal, or local tax returns; and (iii) to the extent provided in Code Sections 6221 through 6231, to represent the Partnership, the General Partner and the Interest Holders before taxing authorities or courts of competent jurisdiction in tax matters affecting the partnership, the General Partner and or Interest Holders in their capacities as General Partner or Interest Holders, and to file any tax returns and to execute any agreements or other documents relating to or affecting such tax matters, including agreements or other documents that bind the General Partner and Interest Holders with respect to such tax matters or otherwise affect the rights of the Partnership. General Partner and Interest Holders. The General Partner is specifically authorized to act as the "Tax Matters Partner" under the Code and in any similar capacity under state or local law;

(k) Take, or refrain from taking all actions, not expressly proscribed or limited by this Agreement, as may be necessary or appropriate to accomplish the purposes of the Partnership;

(l) Institute, prosecutor defend, settle, compromise, and dismiss lawsuits or other judicial or administrative proceedings brought on or in behalf of, or against, the Partnership or the Partners in connection with activities arising out of, connected with, or incidental to

this Agreement, and to engage counsel or others in connection therewith;

(m) Enter into franchising, business opportunity, distribution, sales agent and similar agreements related to the purpose of the Partnership as the General Partner, in its discretion, deems advisable; and

(n) Take such actions as the General Partner deems necessary or prudent in order to protect the status and title of any property owned by, leased by or licensed to the Partnership, including property of a Partner which may be leased or licensed to the Partnership.

In the event more than one Person is a General Partner the rights and powers of the General Partner hereunder shall be exercised by them in such manner as they may agree. In the absence of an agreement among the General Partner, no General Partner shall exercise any of such rights and powers without the unanimous consent of all General Partners.

5.2. RIGHT TO RELY ON GENERAL PARTNER.

(a) Any Person dealing with the Partnership may Rely (without duty of further inquiry) upon a certificate signed by any General Partner as to:

(i) The identity of any General Partner or any Limited Partner;

(ii) The existence or nonexistence of any fact or facts which constitute a condition precedent to acts by a General Partner or which are in any other manner germane to the affairs of the Partnership;

(iii) The Persons who are authorized to execute and deliver any instrument or document of the Partnership; or

(iv) Any act or failure to act by the Partnership or any other matter whatsoever involving the Partnership or any Partner;

(b) The signature of any General Partner shall be necessary and sufficient to convey title to any real property owned by the Partnership or to execute any promissory notes, trust deeds, mortgages, or other instruments of hypothecation and all of the Partner agree that a copy of this Agreement may be shown to the appropriate parties (who enter into appropriate confidentiality agreements) in order to confirm the same,

and further agree that the signature of any General Partner shall be sufficient to execute any "statement of partnership" or other documents necessary to effectuate this or any other provision of this Agreement. All of the Partners do hereby appoint the General Partner as their attorney(s]-in-fact for the execution of any or all of the documents described in this Section 5.2(b).

5.3. RESTRICTIONS ON AUTHORITY OF GENERAL PARTNER.

(a) The General Partner shall not have the authority to, and covenants and agrees that it shall not, do any of the following acts without the unanimous consent of the Partners:

(i) Cause or permit the Partnership to engage in any activity that is not consistent with the purposes of the Partnership as set forth in Section 1.3 , hereof;

(ii) Knowingly do any act in contravention of this Agreement;

(iii) Knowingly do any act which would make it impossible to carry on the ordinary business

of the Partnership except as otherwise provided in this Agreement;

(iv) Knowingly perform any act (that would subject any Limited Partner to liability as a general partner in any jurisdiction;

(v) Cause the Partnership to admit any additional Limited Partners other than pursuant to Section 10.7 hereof..

5.4. DUTIES AND OBLIGATIONS OF GENERAL PARTNER.

(a) The General Partner shall cause the Partnership to conduct its business and operations separate and apart from that of any General Partner or any of its Affiliates, including, without limitation, (i) segregating Partnership assets and not allowing funds or other assets of the Partnership to be commingled with the funds or other assets of; held by, or registered in the name of any General Partner or any of its Affiliates, (ii) maintaining books and financial records of the Partnership separate from the books and financial records of any General Partner and its Affiliates, and observing all Partnership procedures and formalities, (iii) causing the Partnership to pay its liabilities from assets of the Partnership, and (iv) causing

the Partnership to conduct its dealings with third Parties in its own name and as a separate and independent entity.

(b) The General Partner shall take all actions which may be necessary or appropriate (i) for the continuation of the Partnership's valid existence as a limited partnership under the laws of the State of California and of each other jurisdiction in which such existence is necessary to protect the limited liability of the Limited Partners or to enable the Partnership to conduct the business in which it is engaged and (ii) for the accomplishment of the Partnership's purposes, including the acquisition, development, maintenance, preservation, and operation of Property in accordance with the provisions of this Agreement and applicable laws and regulations.

(c) The General Partner shall be under a fiduciary duty to conduct the affairs of the Partnership in the best interests of the Partnership and of the Limited Partners, including the safekeeping and use of all of the Property and the use thereof for the exclusive benefit of the Partnership.

(d) The General Partner shall cause to be provided, or cause the Partnership to carry such insurance as is customary in the business in which the Partnership is engaged and in the places in which it is so engaged.

5.5. INDEMNIFICATION OF GENERAL PARTNER.

(a) The Partnership, its receivers or its trustee (in the case of its receiver or trustee, to the extent of Partnership Property) shall indemnify, save harmless, and pay all judgments and claims against each General Partner or any officers or directors of such General Partner relating to any liability or damage incurred by reason of any act performed or omitted to be performed by such General Partner, officer or director in connection with the business of the Partnership, including attorneys' fees incurred by such General Partner, officer or director in connection with the defense of any action based on any such act or omission, which attorneys' fees may be paid as incurred, including all such liabilities under federal and state securities laws (including the Securities Act of 1933, as amended) and any franchise or business opportunity law or regulation, as permitted by law.

(b) The Partnership , its receiver, or its trustee (in the case of its receiver or its trustee (in the case of receiver or trustee, the extent of Partnership Property) shall indemnify and hold harmless, to the maximum extent permitted by law, each General Partner and Interest Holder from and against any and all liabilities, sums paid in

settlement of claims (if such settlement is consented to by the General Partner), obligations, charges, actions (formal or informal), claims (including, without limitation, claims for personal injury under any theory or for real or personal property, damage), liens, taxes, administrative proceedings, losses, damages (including, without limitation, punitive damages), penalties, fines, court costs, administrative service fees, response and remediation costs, other causes of action, and any other costs and reasonable expenses (including, without limitation, reasonable attorneys', expects', and consultants' fees and disbursements and investigating and data review fees) imposed upon or incurred by any General Partner or Interest Holder (whether or not indemnified against by any other party) arising from and after the date of this Agreement directly or indirectly out of the conduct of the business of the Partnership.

(c) In the event of any action by an Interest Holder against any General Partner, including a Partnership derivative suit, as a vested right of the General Partner, the Partnership shall indemnify, save harmless, and pay all expenses of such General Partner and the General Partner's officers, directors and shareholders, including attorneys' fees, incurred in the defense of such action to the fullest extent permissible under California law.

(d) The Partnership shall indemnify, save harmless, and pay all expenses, costs, or liabilities of any General Partner who for the benefit of the Partnership makes any deposit, acquires any option, or makes any other similar payment or assumes any obligation in connection with any property proposed to be acquired by the Partnership and who suffers any financial loss as the result of such action.

(e) Notwithstanding the provisions of Sections 5.5(a), 5.5(c), and 5.5(d) above, no General Partner or Interest Holder shall be indemnified from any liability for fraud, bad faith or willful misconduct.

(f) Notwithstanding anything to the contrary in any of Sections 5.5(a), 5.5(b), 5.5(c) and 5.5(d) above, in the event that any provision in any of such Sections is determined to be invalid in whole or in part, such Section shall be enforced to the fullest extent permissible under California law, as if the provision of California Corporations Code §204.5(a) were applicable to and had been adopted by the Partnership with respect to its General Partner and its officers, directors and shareholders, and any Limited Partner.

5.6. COMPENSATION AND LOANS.

(a) Compensation and Reimbursement. Except as otherwise provided in this Section 5.6., no Partner shall receive any salary, fee, or draw for services rendered to or on behalf of the Partnership, nor shall any Partner be reimbursed for any expenses incurred by such Partner on behalf of the Partnership.

(b) Expenses. Each General Partner may charge the Partnership for any direct expenses reasonably incurred in connection with the Partnership's business.

(c) Compensation. In consideration of its performance of services on behalf of the Partnership, the General Partner shall receive, as guaranteed payments within the meaning of Code Section 707(c) and not as distributions, a monthly management fee necessary to fund all costs of the General Partner under those three Executive Services Agreements with Gary Hollister, Beverly hollister (sic) and Randy Sefrioui or such future agreements, as necessary, in addition to the distributions of cash and other Property and allocations of Profits, Losses and other items provided for in this Agreement.

(d) Loans. Any Person may, with the consent of the General Partner, lend or advance money to the Partnership or the General Partner. If any Partner shall make any loan or loans to the Partnership or advance money on its behalf, the amount of any such loan or

advance shall not be treated as a Capital Contribution but shall be a debt due from the Partnership. The amount of any such loan or advance by a lending Partner shall be repayable out of the Partnership's cash and small bear interest at such rate as the General Partner and the lending Partner shall agree but not in excess of the maximum rate permitted by law. If any General Partner, or an Affiliate of any General Partner, is the lending Partner, the rate of interest shall be determined by the General Partner taking into consideration, without limitation, prevailing interest rates and the interest rates the lender is required to pay in the event such Lender has itself borrowed funds to loan or advance to the Partnership and the terms and conditions of such loan, including the rate of interest shall be no less favorable to the Partnership than if the lender had been an independent third party.

None of the Partners shall be obligated to make any loan or advance to the Partnership except as otherwise specifically set forth in a written agreement by which the Partner agrees make such a loan. .

5.7. TEMPORARY INVESTMENTS. All property in the form of cash not otherwise invested shall be deposited for the benefit of the Partnership in one or more accounts of the Partnership or any of its Affiliates, maintained in such financial institutions as the General

Partner shall determine or shall be invested in short-term liquid securities or other case-equivalent assets or shall be left in escrow, and withdrawals shall be made only in the regular course of Partnership business on such signature or signatures as the General Partner may determine from to time.

Section 6
ROLE OF LIMITED PARTNERS

6.1. RIGHTS OR POWERS. The Limited Partners shall not have any right or power to take part in the management or control of the Partnership or its business and affairs or to act for or bind the Partnership in any way.

6.2. VOTING RIGHTS OR POWERS. The Limited Partners shall have the right to vote on the matters specifically reserved for their approval or consent which are set forth in this Agreement.

6-3. PROCEDURE FOR CONSENT. In any circumstances requiring the approval or consent of the Limited Partners as specified in this Agreement, such approval or consent shall, except as expressly provided to the contract in this Agreement, be given or withheld in the sole and absolute discretion of the Limited Partners and conveyed in writing to the General Partner not later than

thirty (30) days after such approval or consent was requested by the General Partner. The General Partner may require response within a shorter time, but not less than ten (10) Business Days. A failure to respond in any such time period shall constitute a vote which is consistent with the General Partner's recommendation with respect to the proposal. If the General Partner receives the necessary approval or consent of Limited Partners to such action, the General Partner shall be authorized and empowered to implement such action without further authorization by the Limited Partners.

Section 7
[Intentionally Omitted]

Section 8
BOOKS AND RECORDS

8.1. Books and Records. The Partnership shall maintain at its principal place of business separate books of accounts for the Partnership which shall show a true and accurate record of costs and expenses incurred, all changes made, all credits made and received, and income derived in connection with the conduct of the Partnership and the operation of its business in accordance with generally

accepted accounting principles consistently applied, and, to the extent inconsistent therewith, in accordance with this Agreement. Any Partner or his designated representative shall have the right, at any reasonable time, to have access to and inspect and copy the contents of such books or records.

8.2. REPORTS.

(a) In General. The General Partner shall be responsible for the preparation of financial reports of the Partnership and the coordination of Financial matters of the Partnership with the Partnership's accountants.

(b) Annual Reports. Within one hundred twenty (120) days after the end of each Fiscal Year and at such time as distributions are made to the Partners pursuant to Section 13.2 hereof following the occurrence of a Liquidating Event, the General Partner shall cause to be prepared and each Partner to be furnished with audited financial statements accompanied by a report thereon of the Partnership's accountants stating that such statements are prepared and fairly stated in all material respects in accordance with generally accepted accounting principles, and, to the extent inconsistent therewith, in accordance with this Agreement, including the following:

(i) A copy of the balance sheet of the Partnership as of the last day of such Fiscal Year;

(ii) A statement of income or loss for the Partnership for such Fiscal Year;

(iii) A statement of the Partners' Capital Accounts and changes therein for such Fiscal Year; and

(iv) A statement of Partnership cash flow for such Fiscal Year.

(c) Quarterly Reports. Within forty-five (45) days after the close of each fiscal quarter, the General Partner shall cause to be prepared and each Partner furnished with each of the following as prepared by a financial officer of the Tax Matters Partner in accordance with generally accepted accounting principles, and. to the extent inconsistent therewith, in accordance with this Agreement:

(i) A copy of the balance sheet of the Partnership as of the last day of such fiscal quarter;

(ii) Statements of income and loss and cash flow or such fiscal quarter; and

(iii) Written certification by a financial officer of the Tax Matters Partner that such statements have been prepared in accordance with generally accepted accounting principles or in accordance with this Agreement, as the case may be.

(d) Monthly Reports. The General Partner will provide monthly cash flow statements to all Limited Partners or their designated financial representatives.

8.3. Tax Information. Necessary tax information shall be delivered to each Partner after the end of each Fiscal Year of the Partnership together with the annual reports described in Section 8.2(b) hereof.

Section 9
AMENDMENTS; MEETINGS

9.1. Amendments.

(a) Amendments to this Agreement may be proposed by any General Partner or by Limited Partners holding ten percent (10%) or more of the Interests. Following such proposal, the General Partner shall submit

to the Limited Partners a verbatim statement of any proposed amendment providing that counsel for the Partnership shall have approved of the same in writing as to form, and the General Partner shall include in any such submission a recommendation as to the proposed amendment. The General Partner shall seek the written vote of the Partners on the proposed amendment or shall call a meeting to vote thereon and to transact any other business that it may deem appropriate. A proposed amendment shall be adopted and be effective as an amendment hereto if it receives the affirmative vote of a majority of the Partners.

(b) Notwithstanding Sections 6.3 and 9.1(a), this Agreement shall not be amended without the consent of each Partner if such amendment would (i) convert a Limited Partners interest in the Partnership into a General Partner interest, (ii) modify the limited liability of a Limited Partners, or (iii) alter the interest of a Partner in Profits, Losses, other items, or any Partnership distributions.

9.2. Meetings of the Partners.

(a) Meetings of the Partners may be called by any General Partner and shall be called upon the written request of Limited Partners holding ten percent (10%) or more of the

Interests. The call shall state the nature of the business to be transacted. Notice of any such meeting shall be given to all Partners not less than ten (10) Business Days nor more than thirty (30) days prior to the date of such meeting. Partners may vote in person or by proxy at such meetings. Whenever the vote or consent of Partners is permitted or required under the Agreement, such vote or consent may be given at a meeting of Partners or may be given in accordance with the procedure prescribe e in Section 9.3 hereof. Except as expressly provided in the Agreement, the vote of a majority of the Partners shall control.

(b) For the purpose of determining the Partners entitled to vote on, or to vote at, any meeting of the Partners or any adjournment thereof, the General Partner or the Limited Partners requesting such meeting may fix, in advance, a date as the record date for any such determination. Such date shall not be more than (30) days or less than ten (10) Business Days before any such meeting.

(c) Each Limited Partners may authorize any Person or Persons to act for him by proxy on all matters in which a Limited Partner is entitled to participate, including waiving notice of any meeting, or

voting or participating at a meeting. Every proxy must be signed by the Limited Partners or his attorney-in-fact. No proxy shall be valid after the expiration of eleven (11) months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the Limited Partner executing it.

(d) Each meeting of Partners shall be conducted by the General Partner or such other Person as the General Partner may appoint pursuant to such rules for the conduct of the meeting as the General Partner or such other Person deems appropriate.

9.3. Unanimous Consent The Partnership may take any action contemplated under this Agreement if approved by the unanimous consent of the Partners acting without a meeting, such consent to be provided in writing, or by telephone or facsimile, if such telephone conversation or facsimile is followed by a hard copy of the telephone conversation or facsimilied communication sent by registered or certified mail, postage and charges prepaid, addressed as described in Section 15.1, or to such other address as such Person may from time to time specify by notice to the Partners.

Section 10
TRANSFERS OF INTERESTS; BUY-SELL

10.1. Restriction on Transfers. Except as otherwise permitted by this Agreement, no Interest Holder shall Transfer all or any Portion of his Interests. In the event that any Interest Holder pledges or otherwise encumbers any of its Interests as security for the payment of a Debt, any such pledge or

hypothecation shall be made pursuant to a pledge or hypothecation agreement that requires the pledgee or secured party to be bound by all of the terms and conditions of this Section 10.
of a person or entity either through ownership of _____ securities, by contract or otherwise.

10.2. Permitted Transfers. Subject to the conditions and restrictions set forth in Section 10.3 hereof, an Interest Holder may at any time Transfer all or any portion of his Interests to (a) any other Interest Holder, (b) any member of the transferor's Family, (c) any Affiliate of the transferor, (d) the transferor's executor, administrator, trustee, or personal representative to whom such Interests are transferred at death or involuntarily by operation of law, or (e) any Purchaser in accordance with Section 10.4 hereof (any such Transfer being referred to in this Agreement as a Permitted Transfer"). For purposes hereof, an Interest Holder's "Family" shall include only

such Interest Holder's spouse, natural or adoptive lineal ancestors or descendants, and trusts for his exclusive benefit.

10.3. Conditions to Permitted Transfers. A Transfer shall not be treated as a Permitted Transfer under Section 10.2 hereof unless and until the following conditions are satisfied:

(a) Except in the case of a Transfer of Interests at death or involuntarily by operation of law, the transferor and transferee shall execute and deliver to the Partnership such documents and instruments of conveyance as may be necessary or appropriate in the opinion of counsel to the Partnership to effect such Transfer and to confirm the agreement of the transferee to be bound by the provisions of this Section 10. In the case of a Transfer of Interests at death or involuntarily by operation of law, the Transfer shall be confirmed by presentation to the Partnership of legal evidence of such Transfer, in form and substance satisfactory to counsel to the Partnership. In all cases, the Partnership shall be reimbursed by the transferor and/or transferee for all costs and expenses that it reasonably incurs in connection with such Transfer.

(b) Except in the case of a Transfer at death or involuntarily by operation of law, the transferor shall

furnish to the Partnership an opinion of counsel, which counsel and opinion shall be satisfactory to the Partnership, that the Transfer will not cause the Partnership to terminate for federal income tax purposes and that such Transfer will not cause the application of the rules of Code Sections 168(g)(1)(B) and 168(h) (generally referred to as the "tax exempt entity leasing rules") or similar rules to apply to the Partnership, Partnership Property, or the General Partner and Interest Holders.

(c) The transferor and transferee shall furnish the Partnership with the transferee's taxpayer identification number, sufficient information to determine the transferee's initial tax basis in the Interests transferred, and any other information reasonably necessary to permit the Partnership to file all required federal and state tax returns and other legally required information statements or returns. Without limiting the generality of the foregoing, the Partnership shall not be required to make any

distribution otherwise provided for this Agreement with respect to any transferred Interests until it has received such information.

(d) Except in the case of a Transfer of interests at death or involuntarily by operation of law, either (a) such Interests shall be registered under the Securities Act of 1933, as amended, and any applicable state securities laws, or (b) the transferee shall provide an opinion of counsel, which opinion and counsel shall be satisfactory to the Partnership, to the effect that such Transfer is exempt from all applicable registration requirements and that such Transfer will not violate any applicable laws regulating the Transfer of securities.

(e) Except in the case of a Transfer of Interests at death or involuntarily by operation of law, the transferor shall provide an opinion of counsel, which opinion and counsel shall be reasonably satisfactory to the other Partners, to the effect that such Transfer will not cause the Partnership to be deemed to be an "investment company" under the Investment Company Act of 1940.

10.4. Right of First Refusal. In addition to the other limitations and restrictions set forth in this Section 10, except as permitted by Section 10.2 hereof, no Interest Holder shall Transfer all or any portion of his Interests (the "Offered Interests") unless such Interest Holder (the "Seller") first offers sell the Offered Interest pursuant to the terms of this Section 10.4.

(a) Limitation on Transfers. No Transfer may be made under this Section 10.4 unless the Seller has received a bona fide legally enforceable written offer (the "Purchase Offer") from a Person financial (sic) able and willing to consummate the proposed (the "Purchaser") to purchase the Offered Interest for a purchase price (the Offer Price") denominated and payable in United States dollars at closing or according to specified terms, with or without interest which offer shall be in writing signed by the Purchaser and shall be irrevocable for a period ending no sooner than the day following the end of the Offer Period, as hereinafter defined.

(b) Offer Notice. Prior to making any Transfer that is subject to the terms of this Section 10.4, the Seller shall give to the Partnership and each Limited Partner written notice (the "Offer Notice") which shall include a copy of the Purchase Offer and an offer (the 'Firm Offer") to sell the Offered Interests to the Limited Partners and the General Partner (the "Offerees") for the Offer Price, payable according to the same terms as (or more favorable terms than) those contained in the Purchase Offer, provided that the Firm Offer shall be made without regard to the requirement of any earnest money or similar deposit required of the Purchaser prior to closing, and without regard to any security (other than the Offered Interest) to be provided by the Purchaser for any deferred portion of the Offer Price.

(c) Offer Period. The Firm Offer shall be irrevocable for a period (the "Offer Period") ending at 11:59 p.m., local time at the Partnership's principal place of business, on the ninetieth day following the day of the Offer Notice.

(d) Acceptance of Firm Offer. At any time during the sixty (60) days of the Offer Period, any Offeree who is a Limited Partner may accept the Firm Offer as to all or any Portion of the Offered Interest, by giving written notice of such acceptance to the Seller and General Partner which notice shall indicate the maximum Interests that such Offeree is willing to purchase. In the event that within the first sixty (60) days of the Offer Period, Offerees who are Limited Partners ("Accepting Offerees"), in the aggregate, accept the Firm Offer with respect to all of the Offered Interests, the Firm Offer shall be deemed to be accepted and each such Accepting Offer shall be deemed to have accepted that portion of the Offered Interest that corresponds to the ratio of the Interests that such Accepting Offeree indicated a willingness to purchase to the aggregate Interests all Accepting Offerees indicated a willingness to purchase. At any time after the sixtieth (60th) day of the Offer Period, the General Partner may accept the Firm Offer as to any portion of the Offered Interest that has not been previously accepted by giving

written notice of such acceptance to the Seller. In the event that Offerees including the General Partner ("Accepting Offeres"), in the aggregate, accept the Firm Offer with respect to all of the Offered Interest, the Firm Offer shall be deemed to be accepted. If Offerees do not accept the Firm Offer as to all of the Offered Interest during the Offer Period, the Firm Offer shall be deemed to be rejected in its entirety.

(e) Closing or Purchase Pursuant to Firm Offer. In the event that the Firm Offer is accepted, the closing of the sale of the Offered Interest shall take place within thirty (30) days after the Firm Offer is accepted or, if later, the date of closing set forth in the Purchase Offer. The Seller and all Accepting Offerees shall execute such documents and instruments as may be necessary or appropriate to effect the sale of the Offered Interest pursuant to the terms of the Firm Offer and this Section 10.

(r) Sale Pursuant to Purchase Offer If Firm Offer Rejected. If the Firm Offer is not accepted in the manner hereinabove provided, the Seller may sell the Offered Interest to the Purchaser at any time within sixty (60) days after the last day of the Offer Period, provided that such sale shall be made on terms no more favorable to the Purchaser than the terms contained in the Purchase Offer and provided further that such sale complies with

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other terms, conditions, and restrictions of this Agreement that are applicable to sales of Interests and are not expressly made inapplicable to sales occurring under this Section 10.4. In the event that the Offered Interest is not sold in accordance with the terms of the preceding sentence, the Offered Interest shall again become subject to all of the conditions and restrictions of this Section 10.4.

10-5. PROHIBITED TRANSFERS. Any purported Transfer of Interests that is not a Permitted Transfer shall be null and void and of no force or effect whatsoever; provided that, if the Partnership is required to recognize a Transfer that is not a

Permitted Transfer (or if the Partnership, in its sole discretion, elects to recognize a Transfer that is not a Permitted Transfer), the interest Transferred shall be strictly limited to the transferor's rights to allocations and distributions as provided by this Agreement with respect to the transferred Interests, which allocations and distributions may be applied (without limiting any other legal or equitable rights of the Partnership) to satisfy any debts, obligation, or liabilities for damages that the transferor or transferee of such Interests may have to the Partnership.

In the case of a Transfer or attempted Transfer of Interests that is not a Permitted Transfer, the parties engaging or attempting to engage in such Transfer shall be liable to indemnify and hold harmless the Partnership and the other Partners from all cost, liability, and damage that any of such indemnified Persons may incur (including, without limitation, incremental tax liability and lawyers' fees and expenses) as a result of such Transfer or attempted Transfer and efforts to enforce the indemnity granted hereby.

10.6. RIGHTS OF UNADMITTED ASSIGNEES. A Person who acquires one or more Interests but who is not admitted as a substituted Limited Partner pursuant to Section 10.7 hereof shall be entitled only to allocations and distributions with respect to such Interests in accordance with this Agreement, and shall have no right to any information on or accounting of the affairs of the Partnership, and shall not be entitled to inspect the books or records of the Partnership, and shall not have any of the rights of a General Partner or a Limited Partner under the Act or this Agreement.

10.7. ADMISSION OF INTEREST HOLDERS AS PARTNERS. Subject to the other provisions of this Section 10, a transferee of Interests may be admitted to the Partnership as a substituted Limited Partners only upon

satisfaction of the conditions set forth below in this Section 10.7:

(a) The General Partner consents to such admission, which consent may be given or withheld in the sole and absolute discretion of the General Partner;

(b) The Interests with respect in which the transferee is being admitted were acquired by means of a Permitted Transfer;

(c) The transferee becomes a party to this Agreement as a Limited Partners and executes such documents and instruments as the General Partner may reasonably request (including, without limitation, amendments to the Certificate) as may be necessary or appropriate to confirm such transferee as a Limited Partners in the Partnership and such transferee's agreement to be bound by the terms and conditions hereof;

(d) The transferee pays or reimburses the Partnership for all reasonable legal, filing, and publication costs that the Partnership incurs in connection

with the admission of the transferee as a Limited Partner with respect to the Transferred Interests;

(e) If the transferee is not an individual of legal majority, the transferee provides the Partnership with evidence satisfactory to counsel for the Partnership of the authority of the transferee to become a Partner and to be bound by the terms and conditions of this Agreement.

10.8. COVENANTS; LEGEND.

Each Interest Holder hereby agrees that the following legend may be placed upon any counterpart of this Agreement, the Certificate, or any other document or instrument evidencing ownership of Interests:

> The Partnership Interests represented by this document have not been registered under any securities laws and the transferability of such Interests is restricted. Such Interests may not be sold, assigned or transferred, nor will any assignee, vendee, transferee or endorsee thereof be recognized as having acquired any such Interests by the issuer for any purposes, unless (1) a registration statement under the Securities Act of 1933, as amended, with respect to such Interest shall then be in effect and such transfer, has been qualified under all applicable state securities laws, or (2) the availability of an exemption from such registration and qualification shall be

established to the satisfaction of counsel to the Partnership.

The Interests represented by this document are subject to further restriction as to their sale, transfer, hypothecation, or agreement as set forth in the Agreement of Limited Partnership and agreed to by each Limited Partner. Said restriction provides, among other things, that no Interest may be transferred without first offering such Interest to the other Interest Holders and General Partners, and that no vendee, transferee, assignee, or endorsee of an Interest Holder shall have the right to become a substituted Limited Partner without the consent of all of the General Partners which consent may be given or withheld in the sole and absolute discretion of the General Partner.

10.9. DISTRIBUTIONS AND APPLICATIONS IN RESPECT TO TRANSFERRED INTERESTS. If any Partnership Interest is sold, assigned, or Transferred during any Fiscal Year in compliance with the provisions of this Section 10, Profits, losses, each item thereof, and all other items attributable to the Transferred Interest for such Fiscal Year shall be divided and allocated between

the transferor and the transferee by taking into account their varying Interests during such Fiscal Year

in accordance with Code 706(d), using any conventions permitted by law and selected by the General Partner. All distributions on or before the date of such Transfer shall be made to the transferor, all distributions thereafter shall be made to the transferee. Solely for purposes of making such allocations and distributions, the Partnership shall recognize such Transfer not later than the end of the calendar month during which it is given notice of such Transfer, provided that, if the Partnership is given notice of a Transfer at least ten (10) Business Days prior to the Transfer the Partnership shall recognize such transfer as of the date of such Transfer, and provided further that, if the Partnership does not receive a notice stating the date such Interest was transferred and such other information as the General Partner may reasonably require within thirty (30) days after the end of the Fiscal Year during which the transfer occurs, then all such items shall be allocated, and all distributions shall be made, to the Person who, according to the books and records of the Partnership, was the owner of the Interest on the last day of the Fiscal Year during which the Transfer occurs. Neither the Partnership nor any General Partner shall incur any liability for making allocations and distributions in accordance with the provisions of this Section 10.9, whether or not any

General Partner or the Partnership has knowledge of any Transfer of ownership of any Interest.

Section II
GENERAL PARTNER

11.1. ADDITIONAL GENERAL PARTNERS. Except provided in this Section 11 and Section 13.1 hereof, no Person shall be admitted to the Partnership as a General Partner without the unanimous consent of the Partners.

11.2. COVENANT NOT TO WITHDRAW, TRANSFER, OR DISSOLVE. Except as otherwise permitted by this Agreement, the General Partner hereby covenants and agrees not to (a) take any action to File a certificate of dissolution or its equivalent with respect to itself, (b) take any action that would cause a Voluntary Bankruptcy of such General Partner, (c) withdraw or attempt to withdraw from the Partnership, (d) exercise any power under the Act to dissolve the Partnership, (e) transfer all or any portion of his interest 'in the Partnership as a General Partner, or (f) petition for judicial dissolution of the Partnership. Further, the General Partner hereby covenants and agrees to continue to carry out the duties of a General Partner hereunder until the Partnership is dissolved and liquidated pursuant to Section 13 hereof.

11.3. PERMITTED TRANSFERS.

(a) A General Partner may Transfer all or any portion of his interest in the Partnership as a General Partner (1) at any time to any other General Partner, (2) at any time to any Person who is and remains such General Partner's Wholly Owned Affiliate, (3) at any time involuntarily by operation of law, or (4) to any Person who is approved by all of the other General Partners and a majority of the Limited Partners; provided that no such Transfer shall be permitted unless and until (a) all of

the conditions set forth in Section 10.2 hereof are satisfied as if the Partnership interest being Transferred was an Interest, and (b) the transferor and transferee provide the Partnership with an opinion of counsel, which opinion and counsel shall be acceptable to the other General Partners, to the effect, that such Transfer will not cause the Partnership to become taxable as a corporation for federal income tax purposes.

(b) A transferee of an Interest in the Partnership from a General Partner hereunder shall be admitted as a General Partner with respect to such Interest if, but only if, (1) at the time of such Transfer, such transferee is otherwise a General Partner, (2) the transferee

is a Wholly Owned Affiliate of the transferring General Partner and all of the other General Partner consent to such admission, or (3) the admission of such transferee as a General Partner is approved by all of the other General Partners and a majority of the Limited Partners.

(c) A transferee who acquires a Partnership Interest from a General Partner hereunder by means of a Transfer that is permitted under this Section 11.3, but who is not admitted as a General Partner, shall have no authority to act for or bind the Partnership to inspect the Partnership's books, or otherwise to be treated as a General Partner, but such transferee shall be treated as an Interest Holder who acquired an Interest in a Permitted Transfer under Section 10 hereof.

11.4, PROHIBITED TRANSFERS. By purported Transfer of an interest in the Partnership held by a General Partner that is not permitted by Section ll.3 above shall be null and void and of no force or effect whatever; provided that, if the Partnership is required to recognize a Transfer that is not so permitted (or if the Partnership, in its sole discretion, elects to recognize a Transfer that. is not so permitted), the interest transferred shall be strictly limited to the transferor's rights to allocations and distributions as provided by this Agreement with respect to the transferred interest which allocations and distributions may be applied (without limiting any other legal or equitable rights of the

Partnership) to satisfy any debts, obligations, or liabilities for damages that the transferor or transferee of such interest may have to the Partnership.

In the case of a Transfer or attempted Transfer of a Partnership interest that is not permitted by Section 11.3 above, the parties engaging or attempting to engage in such Transfer shall be liable to indemnify and hold harmless the Partnership and the other Partners from all cost, liability and damage that any of such indemnified Persons may incur (including, without limitation, incremental tax liability and lawyers' fees and expenses) as a result of such Transfer or attempted Transfer and efforts to enforce the indemnity granted hereby.

11.5. TERMINATION OF STATUS AS GENERAL PARTNER.

(a) A General Partner shall cease to be a General Partner upon the first to occur of (i) the Bankruptcy of such General Partner, (ii) the Transfer of a portion of such Partner's interest as a General Partner that causes such General

Partner to hold less than twenty-five percent (25%) of the interest that such Person initially held as a General Partner,

(iii) such General Partner's death, permanent disability, or mental incompetence, (iv) the involuntary Transfer by operation of law of such General Partner's interest in the Partnership, (v) the vote of a majority of the Limited Partners to approve a request by such General Partner to retire, or (vi) the vote of a majority of the Limited Partners to remove such General Partner after such General Partner has attempted to made a Transfer of his Partnership interest that is not permitted by Section 11.3 hereof, committed a material breach of this Agreement or his representations and warranties hereunder, or committed any other act or suffered any other conditions that would justify a decree of dissolution of the Partnership under the laws of the State of Cal California. In the event a Person ceases to be a General Partner without having Transferred his entire interest as a General Partner, Such Person shall be treated as an unadmitted transferee of a Partnership interest as a result of an unpermitted Transfer of an interest pursuant to Section 11.4 hereof.

If a General Partner ceases to be a General Partner for any reason hereunder, such Person shall continue to be liable as a General Partner for all debts and obligations of the Partnership existing at the time such Person ceases to be a General Partner, regardless of whether, at such time, such debts or liabilities were known or unknown, actual or contingent. A Person shall not be liable as a General Partner for Partnership debts and obligations arising after

such Person ceases to be a General Partner. Any debts, obligations, or liabilities in damages to the Partnership of any Person who ceases to be a General Partner shall be collectible by any legal means and the Partnership is authorized, in addition to any other remedies at law or in equity, to apply any amounts otherwise distributable or payable by the Partnership to such Person to satisfy such debts, obligations, or liabilities.

(b) It is the intention of the Partners that the Partnership not dissolve as a result of the cessation of any General Partner's status as a General Partner; provided, however, that if it is determined by a court of competent jurisdiction that the Partnership has dissolved, the provisions of Section 13.1 shall govern.

(c) If at the time a Person ceases to be a General Partner such Person is also a Limited Partners or an Interest Holder with respect to Interests other than his interest as a General Partner, such cessation shall not affect such Person's rights and obligations with respect to such interests.

(d) Election of New General Partners. Provided the Partnership has one or more General Partners, any Partner may nominate one or more Persons for election as additional General Partners. The election of

an additional General Partner shall require an affirmative vote of a majority of the Partners.

Section 12
POWER OF ATTORNEY

12.1. GENERAL PARTNERS AS ATTORNEY[S]-IN -FACT. Each Limited Partner hereby makes, constitutes, and appoints each General Partner and each successor General Partner, with full power of substitution and resubstitution, his true and lawful attorney-in-fact for him and in his name, place, and stead and for his use and benefit, to sign, execute, certify, acknowledge, swear to, file, and record (a) all certificates of limited partnership, amended name or similar certificates, and other certificates and instruments (including counterparts of this Agreement) which the General Partner may deem necessary or appropriate to be filed by the Partnership under the laws of the State of California or any other state or jurisdiction in which the Partnership is doing or intends to do business; (b) any and all amendments or changes to this Agreement and the instruments described in (a), as now or hereafter amended which the General Partner may deem necessary or appropriate to effect a change or modification of the Partnership in accordance with the

terms of this Agreement, including, without limitation, amendments or changes to reflect (i) the exercise by any General Partner of any power granted to it under this Agreement; (ii) any amendments adopted by the Partners in accordance with the terms of this Agreement ; (iii) the admission of any substituted Partner; and (iv) the disposition by any Partner of its Interest; (c) all certificates of cancellation and other instruments the General Partner may deem necessary of appropriate to effect the dissolution and termination of the Partnership pursuant to the terms of this Agreement; and (d) any other instrument which is now or may hereafter be required by law to be filed on behalf of the Partnership or is deemed necessary or appropriate by the General Partner to carry out fully the provisions of this Agreement in accordance with its terms. Each Limited Partner authorizes each such attorney-in-fact to take any further action which such attorney-in-fact shall consider necessary or advisable in connection with any of the foregoing, hereby giving each such attorney-in-fact full power and authority to do and perform each and every act or thing whatsoever requisite or advisable to be done in connection with the foregoing as fully as such Limited Partner might or could do personally, and hereby ratifying and confirming all that any such attorney-in-fact shall lawfully do or cause to be done by virtue thereof or hereof.

12.2. NATURE AS SPECIAL POWER. The power of attorney granted pursuant to this Section 12:

(a) Is a special power of attorney coupled with an interest and is irrevocable;

(b) May be exercised by any such attorney-in-fact by listing the Limited Partners executing any agreement, certificate, instrument, or other document with the single signature of any such attorney-in-fact acting as attorney-in-fact for such Limited Partners; and

(c) Shall survive the death, disability, legal incapacity, bankruptcy, insolvency, dissolution, or cessation, of existence of a Limited Partner and shall survive the delivery of an assignment by a Limited Partner of the whole or a portion of his Interests, except that where the assignment is of such Limited Partner's entire Interests and the assignee, with the consent of the General Partner, is admitted as a substituted Limited Partner, the power of attorney shall survive the delivery of such assignment for the sole purpose of enabling any such attorney-in-fact to effect such substitution.

Section 13
DISSOLUTION AND WINDING UP

13.1. LIQUIDATING EVENTS. The Partnership shall dissolve and commence winding up and liquidating

upon the first to occur of any of the following ("Liquidating Events"):

(a) May 19, 2044;

(b) The sale of all or substantially all of the Property;

(c) The vote by Partners holding fifty percent (50%) or more of the Percentage Interests to dissolve, wind up, and liquidate the Partnership;

(d) The happening of any other event that makes it unlawful, impossible, or impractical to carry on the business of the Partnership; or

(e) The withdrawal or removal of a General Partner, the assignment by a General Partner of its entire interest in the Partnership or any other event that causes a General Partner to cease to be a general partner under the Act, provided that any such event shall not constitute a Liquidating Event if the Partnership is continued pursuant to this Section 13.1.

The Partners hereby agree that, notwithstanding any provision of the Act or the California Uniform Partnership Act, the Partnership shall riot dissolve prior to the occurrence of a Liquidating Event. Upon the occurrence

of any event set forth in Section 13.1(c) Partnership shall not be dissolved or required to be wound up if (x) at the time of such event there is at least one remaining General Partner and that General Partner carries on the business of the Partnership (any such remaining General Partner being hereby authorized to carry on the business of the Partnership), or (y) within ninety (90) days after such event all remaining Partners agree in writing to continue the business of the Partnership and to the appointment, effective as of the date of such event, of one or more additional General Partners. If it is determined, by a court of competent jurisdiction, that the Partnership has dissolved prior to the occurrence of a Liquidating Event, or if upon the occurrence of an event specified in Section 13.1(e) hereof , the Partners fail to appoint a substitute General Partner.

effective as of such event and to agree to continue the business of the Partnership as provided in this Section 13.1, then within an additional ninety (90) days after such determination or the last day of such ninety (90) day period, as the case may be (the "Reconstitution Period"), a two-thirds majority of the Partners may elect to reconstitute the Partnership and continue its business on the same terms and conditions set forth in the Agreement by forming a new limited partnership on terms identical to

those set forth in this Agreement and having as a general partner, a Person elected by such two-thirds majority. Upon any such election by a. two-thirds majority of the Partners, all Partners shall be bound thereby and shall be deemed to have consented thereto. Unless such an election is made within the Reconstitution Period, the Partnership shall wind up its affairs in accordance with Section 13.2 hereof. If such an election is made within the Reconstitution Period, then:

(i) The reconstituted limited partnership shall continue until the occurrence of a Liquidating Event as provided in this Section 13.1;

(ii) If the successor general partner is not a former General Partner, then the interest in the Partnership of any former General Partner shall be treated thenceforth as the interest of a Limited Partners; and

(iii) All necessary steps shall be taken to cancel this Agreement and the Certificate and to enter into a new partnership agreement and certificate of limited partnership and the successor general may for this purpose exercise the powers of attorney granted the General Partner pursuant to Section 14 hereof: provided that the right of a two-thirds majority of the Partners to select a successor general partner and to reconstitute and continue the business of the Partnership shall not exist and may not

be exercised unless the Partnership has received an opinion of counsel that the exercise of the right would not result in the loss of limited liability of any Limited Partner and neither the Partnership nor the reconstituted partnership would cease to be treated as a partnership for federal income tax purposes upon the exercise of such right to continue.

13.2. WINDING UP. Upon the occurrence of a Liquidating Event, the Partnership shall continue solely for the purposes of winding up its affairs in an orderly manner, liquidating its assets, and satisfying the claims of its creditors and Partners and no Partner shall take any action that is inconsistent with, or not necessary to or appropriate for, the winding up of the Partnership business and affairs. To the extent not inconsistent with the foregoing, all covenants and obligations in this Agreement shall continue in full force and effect until such time as the Partnership Property has been distributed pursuant to this Section 13.2 and the Certificate has been canceled in accordance with the Act. The General Partner (or, in the event there is no remaining General Partner, any Person elected by a majority of the Limited Partners) shall be responsible for overseeing the winding up and dissolution of the Partnership, shall take full account of the Partnership's liabilities and Property, shall cause the Partnership Property to be liquidated as promptly as is

consistent with obtaining the fair value thereof, and shall cause

the proceed therefrom, to the extend sufficient therefor, to be applied and distributed in the following order:

(a) First to the payment and discharge of all of the Partnership's debts and liabilities to creditors (including debts to affiliates), other than the General Partner;

(b) Second, to the payment and discharge of all of the Partnership's debts and liabilities to the General Partner;

(c) The balance, if any, one percent (1%) to the General Partner and ninety-nine percent (99%) to the Interest Holder in accordance with their Capital Accounts, after giving effect to all contributions, distributions, and allocations for all periods.

No General Partner shall receive any additional compensation for any services performed pursuant to this 13. Each General Partner understands and agrees that by accepting the provisions of this Section 13.2 setting forth the priority of the distribution of the assets of the

Partnership to be made upon its liquidation, such General Partner expressly waives any right which it, as a creditor of the Partnership might otherwise have under the Act to receive distributions of assets *pari passu* with the other creditors of the Partnership in connection with a distribution of assets of the Partnership in satisfaction of any liability of the Partnership and hereby subordinates to said creditors any such right.

13.3. COMPLIANCE WITH CERTAIN REQUIREMENTS OF REGULATIONS; DEFICIT CAPITAL ACCOUNTS.

In the event the Partnership is "liquidated" within the meaning of Regulations Section 1.704-1(b)(2)(ii)(g), (a) distributions shall be made pursuant to this Section 13 to the General Partner and Interest Holders who have positive Capital Account in compliance with Regulations Section 1.704-1 (b) (2)(ii)(b)(2), and (b) if any General Partner's Capital Account has a deficit balance (after giving effect to all contributions, distributions, and allocations for all Fiscal Years, including the Fiscal Year during which such liquidation occurs), such General Partner shall contribute to the capital of the Partnership the amount necessary to restore such deficit balance to zero in compliance with Regulations Section 1.704-1(b)(2)(ii)(b)(3). If any Interest Holder has a deficit balance in his Capital Account (after giving effect to all

contributions, distributions and allocations for all Fiscal Years, including the Fiscal Year during which such liquidation occurs), such Interest Holder shall have no obligation to make any contribution to the capitol of the Partnership with respect to such deficit, and such deficit shall not be considered a debt owed to the Partnership or to any other Person for any purpose whatsoever. In the discretion of the General Partner, a pro rata portion of the distributions that would otherwise be made to the General Partner and Interest Holders pursuant to this Section 3 may be:

(a) distributed a trust established for the benefit of the General Partner and Interest Holders for the purposes of liquidating Partnership assets, collecting amounts owed to the Partnership, and paying any contingent or unforeseen liabilities or obligations of the Partnership or of the General Partner arising out or or in connection with the Partnership. The assets of any such trust shall be distributed to the General Partner and Interest Holders from time to time in the reasonable discretion of the General Partner, in the same proportions as the amount distributed to such trust by the Partnership would otherwise have been distributed to the General Partner and Interest Holders pursuant to Section 13.2 hereof; or

(b) withheld to provide a reasonable reserve for Partnership liabilities (contingent or otherwise) and to reflect the unrealized portion of any installment obligations owed to the Partnership, provided that such withheld amounts shall be distributed to the General Partner and Interest Holders as soon as practicable.

13.4. DEEMED DISTRIBUTION AND RECONTRIBUTION. Notwithstanding any other provision of this Section 13, in the event the Partnership is liquidated within the meaning of Regulations Section 1.704-1(b)(2)(ii)(g) but no Liquidating Event has occurred, the Property shall not be liquidated, the Partnership's liabilities shall not be paid or discharged, and the Partnership affairs shall not be wound up. Instead, solely for federal income tax purposes, the Partnership shall be deemed to have distributed the Property in kind to the General Partner and Interest Holders, who shall be deemed to have assumed and taken subject to all Partnership liabilities, all in accordance with their respective Capital Accounts and if any General Partner's Capital Account has a deficit balance (after giving effect to all contributions, distributions, and allocations for all Fiscal Years including the Fiscal Year during which such liquidation occurs), such General Partner shall contribute to the capital of the Partnership the amount necessary to restore such deficit to zero in compliance the Regulations Section 1.704-1 (b)(2)(ii)(b)(3). Immediately thereafter, the General

Partner and Interest Holders shall be deemed to have recontributed the Property in kind to the Partnership. which shall be deemed to have assumed and taken subject to all such liabilities.

13.5. RIGHTS OF GENERAL PARTNER INTEREST HOLDERS. Except as otherwise provided in this Agreement, (a) each General Partner and Interest Holder shall look solely to the assets of the Partnership for the return of his Capital Contribution and shall have no right or power to demand or receive property other than cash from the Partnership and (b) no Interest Holder shall have priority over any other Interest Holder as to the return of his Capital Contributions, distributions, or allocations.

13.6. NOTICE OF DISSOLUTION. In the event a Liquidating Event occurs or an event occurs that would, but for provisions of Section 13.1, result in a dissolution of the Partnership, the General Partner shall, within 30 days thereafter, provide written notice thereof to each of the Partners and to all other parties with whom the Partnership regularly conducts business (as determined in the discretion of the general Partner) and shall publish notice thereof in a newspaper of general circulation in each place in which the Partnership regularly

conducts business (as determined in the discretion of the General Partner) .

Section 14
MISCELLANEOUS

1.4.1. NOTICES. Any notice, payment, demand, or communication required or permitted to be given by any provision of this Agreement shall be in writing and sent by overnight courier, or by telephone or facsimile, if such telephone conversation or facsimile is followed by hard copy of the telephone conversation or facsimilied communication sent by overnight courier, charges prepaid and addressed as follows, or to such other address as such Person may, from time to time specify by notice to the Partners:

(a) If to the Partnership, to the Partnership at the address set forth in Section 1.4 hereof;

(b) If to a General Partner, to the address set forth in Section 2.1 hereof; and

(c) If to a Limited Partners, to the address set forth opposite his name on Exhibit A attached hereto.

Any such notice shall be deemed to be delivered, given, and received for all purposes as of the date so delivered.

14.2. BINDING EFFECT. Except as otherwise provided in this Agreement, every covenant, term, and provision of this Agreement shall be binding upon and inure to the benefit of the Partners and their respective heirs, legatees, legal representatives, successors, transferees, and assigns.

14.3. CONSTRUCTION. Every covenant, term, and provision of this Agreement shall be construed simply according to its fair meaning and not strictly for or against any Partner. The terms of this Agreement are intended to embody the economic relationship among the Partners and shall not be subject to modification by, or be conformed with, any actions by the Internal Revenue Service except as this Agreement may be explicitly so amended and except as may relate specifically to the filing of tax returns.

14.4. TIME. Time is of the essence with respect to this Agreement.

14.5. HEADINGS. Motion and other headings contained in this Agreement are for reference purposes only and are not intended to describe, interpret, define, or

limit the scope, extent, or intent of this Agreement or any provision hereof.

14.6. SEVERABILITY. Every provision of this Agreement is intended to be severable. If any ter or provision hereof is illegal or invalid for any reason whatsoever, such illegality or invalidity shall not affect the validity or legality of the remainder of this Agreement.

14.7. INCORPORATION BY REFERENCE. Every exhibit, schedule, and other appendix attached to this Agreement and referred to herein is not incorporated in this Agreement by reference unless this Agreement expressly otherwise provides.

14.8. FURTHER ACTION. Each Partner, upon the request of any General Partner agrees to perform all further acts and execute, acknowledge, and deliver any documents which may be reasonably necessary, appropriate, or desirable to carry out the provisions of this Agreement.

14.9. VARIATION OF PRONOUNS. All pronouns and any variations thereof shall be deemed to refer to masculine, feminine, or neuter, singular or plural, as the identity of the person or persons may require.

14.10. GOVERNING LAW. The laws of the State of California shall govern the validity of this Agreement, the construction of its terms and the interpretation of the rights and duties of the Partners.

14.11. WAIVER OF ACTION FOR PARTITION; NO BILL FOR PARTNERSHIP ACCOUNTING. Each of the Partners irrevocably waives any right that he may have to maintain any action for partition with respect to any of the Property. To the fullest extent permitted by law, each Partner covenants that it will not (except with the consent of the General Partner) file a bill for Partnership accounting.

14.12. COUNTERPART EXECUTION. This Agreement may be executed in any number of counterparts with the same effect as if all of the Partners had signed the same document. All counterparts shall be construed together and shall constitute one agreement.

14.13. SOLE AND ABSOLUTE DISCRETION. Except as otherwise provided in this Agreement, all actions which any General Partner may take and all determinations which any General Partner may make pursuant to this Agreement may be taken and made at the sole and absolute discretion of such General Partner.

14.14. SPECIFIC PERFORMANCE. Each Partner agrees with the other Partners that the other Partners would be irreparably damaged if any of the provisions of this Agreement are not performed in accordance with their specific terms and that monetary damages would not provide an adequate remedy in such event. Accordingly, it is agreed that,, in addition to any other remedy to which the nonbreaching Partners may be entitled, at law or in equity, the nonbreaching Partners shall be entitled to

injunctive relief to prevent breaches of the provisions of this Agreement and specifically to enforce the terms and provisions in any action instituted in any court of the United States or any state thereof having subject matter jurisdiction thereof..

IN WITNESS WHEREOF the parties have entered into this Agreement of Limited Partners as of the day first above set forth.

JEANNE PIAUBERT MANAGEMENT, INC. a California corporation	JEANNE PIAUBERT, S.A. a French corporation
/s/ Beverly Hollister	/s/ Jacques Konckier
By: Beverly Hollister	By: Jacques Konckier
Its: President	Its: President

GLH, INC.,

California corporation

/s/ Gary Hollister
By: Gary Hollister

BAH, INC., a California corporation

/s/ Beverly Hollister
By: Beverly Hollister

EL FADL, INC.,
a Nevada corporation

/s/ Randy Sefrioui
By: Randy Sefrioui

EXHIBIT A

AGREEMENT OF LIMITED PARTNERSHIP

OF

JEANNE PIAUBERT COSMETICS, LP

Limited Partners

NAMES AND ADDRESSES	CAPITAL CONTRIBUTIONS	INTERESTS
GLH, Inc.	$1650	16.5%
BAE, Inc.	$1650	16.5%
El Fadl, Inc.	$1650	16.5%
The Fragrance Group, Ltd.	$4950	49.5%
		99.0%

General Partner

NAMES AND ADDRESSES	CAPITAL CONTRIBUTIONS	INTERESTS
Jeanne Piaubert Management, Inc.	$100	1.0%

EXHIBIT "D"

SHAREHOLDER'S AGREEMENT
OF
JEANNE PIAUBERT HOLDINGS, INC.

THIS SHAREHOLDERS' AGREEMENT (the "Agreement") is dated as of May 1994 and entered into by and among **Jeanne Piaubert S.A.**, a French corporation, **Gary Hollister, Beverly Hollister** and **Randy Sefrioui** (the "Shareholders") and **Jeanne Piaubert Holdings, Inc.**, a California corporation ("Company").

PRELIMINARY STATEMENTS

A. Each of the Shareholders owns the number of shares of the common stock of the Company as listed on Schedule A attached hereto, and the shares listed on Schedule A constitute all of the issued and outstanding shares of the Company. The shares listed on Schedule A, together with any other shares of capital stock of the Company hereafter acquired by any Shareholder, are hereinafter referred to as the "Shares."

B. The Company owns all of the issued and outstanding capital stock of Jeanne Piaubert Management, Inc., a California corporation (the "General Partner"). The General Partner is the sole general partner of Jeanne Piaubert Cosmetics, LIMITED PARTNERS, a California limited partnership d/b/a/ Jeanne Piaubert Cosmetics Ltd..

EXHIBIT "D"

(the "Operating Company").

C. In order to provide for the stability of the Company and to promote continuity of its management and policies, the Shareholders desire to enter into this Agreement in accordance with the provisions of Section 300 of the California Corporations Code (the "Code") to define certain of their rights and obligations regarding the management and conduct of the business of the Company and to restrict the manner and means by which the Shares may be sold, otherwise transferred.

D. Jeanne Piaubert S.A., a French corporation and a Shareholder (the "Strategic Shareholder") concurrently with the execution of this Agreement has agreed to make a loan and/or facilitation(s) to the Operating Company of U.S. $5,000,000 pursuant to the terms hereof and the Promissory Note attached hereto as Schedule B (the "Capital Note"). The period of time commencing upon the date hereof until the date upon which all amounts due and owning under the Capital Note are paid in full ("Recoupment") shall be referred to herein as the "Pre-Recoupment Period." The period commencing upon payment in full of the Capital Note and thereafter shall be referred to herein as the "Post-Recoupment Period."

NOW THEREFORE, in consideration of the mutual benefits to be derived herefrom and of the mutual agreements hereinafter set forth, the parties hereto agree as follows:

1. BOARD OF DIRECTORS

1.1. NUMBER OF DIRECTORS. During the Pre-Recoupment Period, the Board of Directors of the Company shall consist of seven persons. During the Pre-Recoupment Period, the Strategic Shareholder shall have the right to appoint four of the seven persons of the Board of Directors of the Company. During the Post--Recoupment Period, the Board of Directors of the Company shall consist of five persons. During the Post-Recoupment Period, the Shareholders (other than the Strategic Shareholder) (the "Operating Shareholders") shall be entitled to appoint three of the five persons of the Board of Directors of the Company.

1.2. ELECTION. The initial Board of Directors of the Company during the Pre-Recoupment Period shall consist of the following persons, each of whom shall hold office until their successors are duly elected and qualified:

Jacques Konckier
Regine Konckier
David Konckier

Didier Hesse
Gary Hollister
Beverly Hollister
Randy Sefrioui

1.3. TERM. The Directors shall hold office until resignation or death or removal by the Shareholders in accordance with this Agreement or the Bylaws. Any vacancies on the Board due to resignation or death of any director or removal by the Shareholders shall be filled in such a manner so as to maintain the appointment rights set forth in Section 1.1 hereof.

1.4. POWERS. The business and affairs of the Company shall be managed and all corporate powers shall be exercised by or under the direction and control of the Board of Directors. The officers shall administer such powers for the Board of Directors, all in accordance with the Code. In no event shall the officers or the Board of Directors cause the Company to take any of the following actions without the prior written consent of the holders of a majority of the Shares then outstanding:

1. Issue or sell any additional shares of common stock or other securities of the Company;

2. Sell, assign, transfer, lease, convey or dispose of all or substantially all of the assets of the Company, except in the ordinary course of business;

3. Merge with or into or consolidate with any other entity;

(4) Change the Company's business purpose;

(5) Cancel the License Agreement between the Strategic Shareholder and the Operating Company; or

(6) Purport to amend this Shareholders' Agreement.

2. OFFICERS

2.1.OFFICERS. The officers of the Company shall consist of a Chief Executive Officer, a President, a Chief Operating Officer, one or more Vice Presidents, a Chief Financial Officer, a Secretary and any other officers required by law or designated by the Board of Directors.

2.2. ELECTION. The officers of the Company during the Pre-Recoupment Period shall be:

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Regine Konckier	-	Chief Executive Officer
Jacques Konckier	-	Chief Financial Officer
David Konckier	-	Executive Vice-President
Didier Hesse	-	Executive Vice-President
Gary Hollister	-	Executive Vice-President
Beverly Hollister	-	Executive Vice-President
Randy Sefrioui	-	Executive Vice-President, Secretary

The officers of the Company during the Post-Recoupment Period shall be:

Gary Hollister	-	Chief Executive Office
Beverly Hollister	-	Executive Vice-President and Secretary
Randy Sefrioui	-	Executive Vice-President and Chief Financial Officer
Jacques Konckier	-	Executive Vice-President
Regine Konckier	-	Executive Vice-President

2.2. ELECTION. The officers set forth in Section 2.2 shall hold office until such officers resign, or upon the death, disability or incompetency of such officer. Upon the occurrence of any of the foregoing events, the

vacancy shall be filled pursuant to this Agreement and the Bylaws.

2.4. SERVICES FOR GENERAL PARTNER. Gary Hollister, Beverly Hollister and Randy Sefrioui shall also serve as officers and directors of the General Partner during the Pre-Recoupment and Post-Recoupment Periods in the following capacities:

Beverly Hollister	-	Chair of the Board and President
Gary Hollister	-	Chief Executive Officer
Randy Sefrioui	-	Vice Chairman and Chief Operating Officer

Such officers of the General Partner shall hold office until death, disability, resignation or termination of such officer. Any termination shall be Pursuant to action by the Board of Directors of the General Partner upon being directed by the Board of Directors of the Company, in its capacity as sole shareholder of the General Partner.

2.5. EXECUTIVE SERVICES AGREEMENTS. Gary Hollister, Beverly Hollister and Randy Sefrioui shall

enter into an Executive Services Agreement in the form of Schedules C, D and E, respectively, attached hereto.

The remaining officers shall receive compensation for the performance of their duties in such amounts and at all times as the Board of Directors determines in its sole discretion.

3. INDEMNIFICATION. Company is authorized to and will provide indemnification of agents (as defined in Section 317 of the California Corporations Code) for breach of duty to the Company and its shareholders by bylaw or through agreements with the agents, or both, in excess of the indemnification otherwise permitted by Section 317 of the California Corporations Code, subject to the limits on such excess indemnification set forth in Section 204 of the California Corporations Code.

4. OPTION. Concurrently herewith, the Strategic Shareholder has entered into an option agreement in the form of Schedule F hereto with the Operating Shareholders. Pursuant to such option agreements, each Operating Shareholder shall have the right to purchase 56 Shares from Strategic Shareholder upon Recoupment by the Strategic Shareholder, with adjustments as provided in the Option Agreements, so that following Recoupment the Strategic Shareholder will bold 499 Shares and the

Operating Shareholders will hold 501 Shares. The terms of such option to purchase are governed exclusively by such option contracts.

5. LICENSE AGREEMENT. An affiliate of the Strategic Shareholder shall enter into the License Agreement in the form of Schedule G hereto pursuant to which certain property rights of Strategic Shareholder's affiliate necessary and integral to the operation of the business of the Operating Company shall be licensed to the Operating Company, all on the terms set forth in such license agreement.

6. STRATEGIC SHAREHOLDER LOAN. The Strategic Shareholder shall make loan(s) in monthly installments as set forth on the cash flow statemnet (sic) attached hereto as Schedule H. The Capital Note has been structured in the form of a revolving loan (rather than a lump sum loan) (i) so that the Strategic Shareholder need not fund amounts to the Operating Company prior to the time that the capital is actually needed by the Operating Company; and (ii) to avoid interest charges on Capital Note financings, although all parties acknowledge that all $5,000,000 will be funded to the Operating Company by December 31, 1995.

7.1. RESTRICTION ON TRANSFER OF SHARES.

7.1.1. RESTRICTION ON SHARES. None of the Shares now or hereafter owned or held by any of the Shareholders or their successors and assigns, nor any voting trust certificates issued in respect of such Shares, may be sold, assigned, transferred, pledged, hypothecated, or in any other way disposed of or encumbered, voluntarily or involuntarily except in accordance with the terms of this Agreement. No sale, transfer or other disposition of Shares shall be valid, effective, entitled to recognition for any purpose, including voting or dividend rights, or made on the books of the Company, if made in violation of the provisions of this Agreement. No Shares may be voluntarily encumbered or subjected to a lien or security interest of any kind by any Shareholder and any such encumbrance, lien or security interest shall be null and void and of no force and effect, except is provided in this Agreement.

7.1.2. PERMISSIBLE TRANSFERS. Notwithstanding anything to the contrary set forth in this Agreement, the restrictions on transfer specified herein shall not apply to any disposition in favor of one or more family trusts established for the benefit of a Shareholder and/or his or her spouse and/or lineal descendants provided, and only for so long as, such Shareholder retains

the sole voting control over the Shares, in a trustee capacity or otherwise. Any transferee(s) under this provision shall hold the Shares subject to all the provisions of this Agreement.

7.2. RIGHT OF FIRST REFUSAL TO PURCHASE SHARES. Upon the happening of any of the following events ("Triggering Events") with respect to a Shareholder or with respect to any of the Shares held by such Shareholder (such Shareholder sometimes referred to as the "Affected Shareholder"), the Company and the remaining Shareholders shall have the right and option to purchase all Shares of the Affected Shareholder at the price and upon the terms hereafter provided in this Agreement:

7.2.1. **BONA FIDE OFFER.** In the event a Shareholder shall desire to sell or transfer any Shares, such Shareholder shall give written notice thereof to the Company and all other Shareholders, whereupon the Company and the remaining Shareholders shall have the right and option to purchase the Shares proposed to be transferred at the price and upon the terms hereafter provided in this Agreement. The

terms of such transaction and the identity of the offeror(s) shall be set forth in full in the notice to the Company and

the remaining Shareholders. Such offer must be in writing setting forth all relevant terms and conditions of purchase from an offeror who has made a legally binding written offer to the offerer and is ready, willing and able to consummate the purchase and who is not directly or indirectly related to or affiliated with such Shareholder.

7.2.2. DEATH OR DISSOLUTION. The death of an individual Shareholder or, in the case of a Shareholder that is a corporation, the filing of a Certificate of Election to Wind Up and Dissolve or a Certificate of Dissolution, or its equivalent.

7.23. INVOLUNTARY TRANSFERS. Any purported involuntary transfer, sale or other disposition of any Shares, whether by operation of law, pursuant to court order, foreclosure of a security interest, execution of a judgment or other legal process, or otherwise, and including but not limited to, a purported transfer to a trustee in bankruptcy, receiver, or assignee for the benefit of creditors.

7.2.4. BANKRUPTCY. The entry of an order for relief against a Shareholder under federal bankruptcy law or of a Shareholder (i) makes the general assignment for the benefit of creditors, (ii) files a voluntary petition under federal or applicable bankruptcy law, a petition or Answer seeking for such Shareholder any reorganization,

arrangement, composition, readjustment, liquidation, dissolution or similar relief under any statute, law or regulation, or files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against such Shareholder in any proceeding of this nature, or (iv) seeks, consents to, acquiesces in or otherwise suffers the appoint of a trustee, receiver, or liquidator of such Shareholder or of all or any substantial part of such Shareholder's properties.

7.2.5. OPTION PERIODS. The Company shall have the right arid option for a period ending 30 calendar days from the date upon which (i) it has been given notice of a Triggering Event and (ii) has occurred the determination of the purchase price of the Shares, to purchase the Shares available for purchase at the price and upon the terms hereafter provided in this Agreement, and the remaining Shareholders, pro rata in accordance with their prior ownership of Shares, shall then have the right and option, for a. period of 20 days thereafter, to purchase any Shares not purchased by the Company upon the same terms and conditions as exist in favor of the Company. If all remaining Shareholders do not elect to purchase the remaining Shares, then the Shareholders electing to purchase shall have the right, pro rata in accordance with their prior ownership of Shares, to purchase the additional Shares available for purchase.

7.3. PURCHASE PRICE. When any option to purchase Shares arises under this Agreement, the purchase price for such Shares shall be determined as follows:

7.3.1. VOLUNTARY SALE. With respect to any option to purchase Shares pursuant to Section 7.2.1 hereof, the purchase price shall be the purchase price contained in the

the Bona Fide Offer, and the purchase shall be made upon the terms specified in the Bona Fide Offer.

7.3.2. BY AGREEMENT. When any option to purchase Shares arises under any other Section hereof, the Affected Shareholder, the transferee or the executor or administrator, as the case may be, and the Company shall attempt to agree upon a purchase price for such Shares following receipt by the Company of notice of the Triggering Event.

7.33. APPRAISAL IF NO AGREEMENT. If the above parties are unable to agree upon a purchase price after 30 days of negotiation (or attempted negotiation), the, parties shall within 10 days thereafter agree upon an appraiser to value the fair market value of the Shares. If no agreement has been reached upon an appraiser within 60 days after the notice of the Triggering

Event, the Company shall within 3 days choose one appraiser by notice to the transferring Shareholder, the transferee, or the Shareholder's executor or administrator, as the case may be (the "Transferring Shareholder"), and the Transferring Shareholder shall promptly within 3 days choose one such appraiser by notice to the Company. The two appraisers so selected shall then within 3 days appoint a third appraiser and the three appraisers so selected shall conduct and complete an appraisal of the fair market value of the Shares within 3 days after the section of the third appraiser. The agreed decision of the three appraisers shall govern. The determination of the purchase price in such manner shall be conclusive for all purposes and on all parties.

If either the Company or the Transferring Shareholder shall fail to appoint such an appraiser within 30 calendar days after the lapse of the 66 day period referred to above, then, the appraiser appointed by the party which does appoint an appraiser shall alone determine the fair market value of the Shares and such appraisal shall govern.

Each party shall compensate the appraiser appointed by such party, and the compensation of the third appraiser and the expenses of appraisal shall be borne equally by the Company and the Transferring Shareholder. The portion of such compensation and fees

allocated to the Company and any other Shareholders electing to purchase Shares, on a pro rata basis to the number of Shares purchase by the Company and each such other Shareholder respectively.

7.3.4. FACTORS TAKEN INTO ACCOUNT. In making the appraisal, the appraisers shall determine the fair market value of the Shares in question by whatever methods and/or formulae they deem appropriate in their discretion and taking into account whatever factors they deem appropriate in their discretion, including any restrictions upon sale imposed hereunder by applicable securities laws.

7.3.5. PAYMENT. Except as hereinafter provided, the Purchase Price shall be payable at the option of the Company or each purchasing Shareholder, either - entirely in cash or partly in cash and partly by delivery of a promissory note. In no event, however, shall the Company or any purchasing Shareholder make an initial cash payment of less than 25% of the purchase price of any Shares to be purchased by the Company or any such Shareholder.

7.3.6. PROMISSORY NOTE. Any note for the balance unpaid in cash for the Shares shall be payable

over two (2) years in semi-annual installments, with interest fixed at 110% of the applicable federal rate as described in Section 1274(d) (1)(A) of the Internal Revenue Code, as amended, as of the date of the Note. Such Note shall provide that any sums paid in any period in excess of the regular installment for such period shall be applied against installments thereafter falling due in the inverse order of their maturity or against all of the remaining installments equally, at the option of the maker. Each such Note shall also provide that in case of default in the payment of any installment when due, the entire principal balance then remaining unpaid shall become immediately due and payable at the option of the holder, and shall provide for the payment by the maker of reasonable attorneys' fees to the holder in the event suit is commenced because of any default. Each such Note executed by a Shareholder shall be secured by a pledge of the purchased Shares, and guaranteed by a personal guaranty of such Shareholder, to the selling Shareholder, such Shareholder estate or transferee, as the case may be, or to any other person, firm or corporation as may be agreed upon by the parties. Each such Note executed by the Company shall be guaranteed by a personal guaranty of the majority Shareholder of the Company at such time (if any Shareholder holds a majority of the Shares of the Company at such time), and shall be secured by a pledge by the Shareholders of the same number of Shares purchased by the Company pro rata in accordance with

their shareholders in the Company after consummation of the purchases contemplated by this Agreement. So long as no default occurs in the making of payments on any such Note, the purchaser shall be entitled to receive all dividends paid on the pledged Shares and to vote them. No Shares shall be released from such pledge unless and until the Note shall have been paid in full.

7.3.7. CLOSING. Unless the parties involved mutually agree otherwise, delivery to the Company and/or the Shareholders of the share certificates representing the Shares to be sold pursuant to this Agreement and payment of the purchase price therefor shall take place at a closing to be held at the principal office of the Company at 10:00 a.m. within 30 calendar days following the termination of the last applicable option period or within 5 business days following receipt by the Company of the proceeds from a Stock Purchase Funding Policy, whichever is later. At such closing (the "Closing"), the selling Shareholder or the Shareholder's executor or administrator, or the transferee, as the case may be, shall deliver to the Company and/or the Shareholders electing to purchase Shares all share certificate representing the Shares to be purchased, any other documents reasonably requested by the Company and/or such Shareholders to effectuate the purposes of this Agreement.

7.4. TERMS OF OPTIONS.

7.4.1. TERMINATION OF OPTIONS.

(1) Voluntary Transfers. If the Company and/or the other Shareholders do not purchase all of the Shares subject to the right of first refusal pursuant to Section 7, the transferring Shareholder may sell or transfer all of the Shares to the transferee upon the same terms as set forth in the notice provided to the Company, provided the transferee of such Shares agrees in writing to be bound by the terms and conditions of this Agreement. Any such voluntary transfer must be effected within 90 calendar days after the date of the termination of the Shareholders' options as provided herein. If, at the expiration of said 90-day period the Shares proposed to be transferred have not been transferred, such Shares shall continue to be subject to all of the provisions of this Agreement and may not thereafter be transferred except in the manner and upon the terms herein provided.

(2) Other Events. In all other events, the Company and the remaining Shareholders shall be entitled to purchase all or any part of the Shares available for purchase, notwithstanding the fact that the Corporation and the Shareholders may not have elected to purchase the full number of such Shares. The transferee of

such Shares shall hold the Shares subject to all of the provisions of this Agreement.

7.5. REPURCHASE RESTRICTIONS IMPOSED BY LAW. The Company's right to exercise any option provided for herein shall be subject to the restrictions governing the right of a corporation to purchase its own stock as set forth in Section 500 *el seq.* of the, California Corporation Law or its successor, and such other pertinent governmental restrictions as may now or hereafter be in effect.

7.6. INSURANCE ON LAWS S OF SHAREHOLDERS. The Company may, at the exclusive discretion of its officers, purchase and maintain in effect insurance on the lives of the Shareholders, or any of them, for the purpose of providing funds which will enable the Company to purchase all or part of the Shares owned by any deceased Shareholder at the time of his death. Any insurance policy or policies purchased and maintained by the Company for this purpose shall be designated as "Stock Purchase Funding Policies". Each Shareholder agrees to cooperate with the Company in all reasonable respects to enable the Company to purchase such insurance on such Shareholder's life, including, but not limited to, submitting to standard physical examinations and blood tests required by insurance companies for the purpose of obtaining the insurance.

8. ENDORSEMENT OF SHARE CERTIFICATES. Each of the certificates representing the Shares shall bear the following legend:

> "None of the Shares represented by this certificate may be sold, assigned, transferred, pledged, hypothecated or in any other way disposed of or encumbered, voluntarily or involuntarily, by gift, bankruptcy, operation of law, winding up of a corporation or otherwise, except in accordance with the provisions of the Shareholders' Agreement dated as of [the date hereof], a copy of which may be inspected at the principal office of this Corporation and all of the provisions of which are incorporated herein."

A copy of this Agreement shall be delivered to the Secretary of the Company and shall be shown by him to any person making inquiry concerning it.

8.1. MARITAL DISSOLUTION OR DEATH OF A SPOUSE.

8.1.1. MARITAL DISSOLUTION. Upon the dissolution of the marital relationship of a Shareholder or execution of the marital relationship of a Shareholder or

execution of a binding agreement or issuance of an order with respect to marital property of a Shareholder, that Shareholder ("Separated Shareholder") and his or her spouse use all reasonable, efforts to cause the Shares held by either of them, including the former spouse's interest therein, if any (community or otherwise), to be distributed or transferred to the Separated Shareholder. If such distribution or transfer cannot be accomplished for any reason, the Separated Shareholder shall purchase the Shares of his or her former spouse and such former spouse shall sell the Shares to the Separated Shareholder on the terms and at the price set forth in this Agreement. If such distribution or sale does not occur for any reason whatsoever within 180 days after division of the community, the Company and the remaining Shareholders shall have the right and option to purchase the remaining interest in the Shares retained by the former spouse at the price and upon the terms hereafter set forth in this Agreement. A Separated Shareholder shall promptly notify the Company and the other Shareholders in writing of any dissolution of his or her marital relationship, any disposition of the Shares by reason thereof and any property settlement proceedings which provide the Company and the Shareholders any purchase rights hereunder.

8.1.2. DEATH OF SPOUSE. Upon the death of a spouse of a Shareholder, that Shareholder ("Surviving

Shareholder") shall use all reasonable efforts to cause the deceased spouse's interest in the Shares, if any (community or otherwise), to be distributed or transferred to him or her. If the interest of the deceased spouse is not held by the Surviving Shareholder directly or in trust whereby the Surviving Shareholder is the sole trustee and has the primary beneficial interest in the trust, then the Surviving Shareholder shall purchase the Shares of his or her deceased spouse and the estate or successor in interest of such deceased spouse's interest shall sell the interest to the Surviving Shareholder on the terms and at the price set forth in this Agreement. If such disposition or sale does not occur for any reason whatsoever within 180 days after

the date or death, the Company and the remaining interest in the Shares of the deceased spouse at the price and upon the terms hereafter set forth in this Agreement. A Shareholder shall promptly notify the Company and the other Shareholders in writing of the death of a Shareholder's spouse and the disposition of any Shares by reason thereof which provide the Company and the Shareholders any purchase rights hereunder.

If any Shares are held in a trust for the benefit of a Shareholder by virtue of the death of such Shareholder's spouse, upon the earlier of such

Shareholder's death or such Shareholder ceasing to act as sole trustee, then the Company and the remaining Shareholders shall have the right to purchase the Shares so held in trust upon the terms and conditions set forth in this Agreement.

9. ENFORCEMENT. The transfer restrictions of this Agreement shall be deemed to be of the essence of the ownership of Shares. Upon application to any court of competent jurisdiction, the Company shall be entitled to a decree against any person violating or about to violate the provisions hereof, requiring specific performance of any of the provisions herein, including those requiring a Shareholder to sell his Shares, or any part thereof to the Company and/or the other Shareholders or prohibiting a transfer or disposition of the Shares in violation hereof.

10. RECAPITALIZATIONS. In the event the Company is a party to any reorganization, recapitalization, reclassification, readjustment or other change in its capital structure wherein any other shares or securities of the Company are to be issued in respect of all or part of the Shares then such other shares or securities shall likewise be subject to all of the terms and provisions of this Agreement.

11. DISSOLUTION. In the event that any of the Shareholders wish to dissolve the Company, each

Shareholder agrees that to elect to voluntarily dissolve the Company, the number of votes held by the Shareholders and cast in favor of such a dissolution shall be required to be greater than seventy percent (70%) of the Shares bound hereby. Each of the Shareholders hereby acknowledges that he is aware of the content of Section 1900(a) of the California Corporations Code and expressly waives its protection, rights, and application to this Agreement. Section 1.900(a) states the following:

"Any corporation may elect voluntarily to wind up and dissolve by the vote of shareholders holding shares representing 50 percent or more of the voting power."

The Agreement among the Shareholders evidenced by this Section cannot be waived or amended by any Shareholder acting alone, but may only be waived or amended by the written consent. of all of the Shareholders.

12. TERMINATION OF AGREEMENT. This Agreement shall terminate, and the certificates representing the Shares and any insurance policies subject to this Agreement shall be released from the terms of this Agreement upon the following events:

12.1. BY AGREEMENT. The written agreement of the Company and the Shareholders then

holding greater than seventy percent (70%) of the Shares bound;

12.2. ONE SHAREHOLDER. At such time as there is only one remaining Shareholder of the Company;

12.3. LIQUIDATION. The liquidation and dissolution of the Company; or

12.4. BANKRUPTCY. The commencement of proceedings in bankruptcy or receivership of the Company, which are not dismissed within 60 days of the initial filing thereof; or

12.5. CORPORATE STATUS. If the Company ceases to be a close corporation.

However, the termination of this Agreement shall not affect or diminish any obligations of the parties hereto to pay for any Shares actually purchased prior to such termination. Upon the termination of this Agreement for any of the above reasons, the certificates of stock hold by each Shareholder shall be surrendered to the Company, ane the Company shall issue new certificates for the same number of Shares but without the endorsement required by this Agreement.

13. NOTICES. All notices, requests and other communications hereunder shall be in writing and shall be deemed to have been given if delivered by courier or other means of personal service, or if sent by telex or telecopy or mailed first class, postage prepaid, by certified mail, return receipt requested, addressed to the Company at 1901 Avenue of the Stars, Suite 1100, Los Angeles, CA 90067, and to each Shareholder at the notice address listed on the signature pages hereto.

All notices, requests and other communications shall be deemed received on the date of actual receipt as evidenced by written receipt acknowledgement (sic) or other evidence of actual receipt.

14. GENERAL PROVISIONS.

14.1. WAIVER. No waiver of any provision of this Agreement in any instance shall be or for any purpose be deemed to be it waiver of the right of any party hereto to enforce strict compliance with the Provisions hereof in any subsequent instance.

14.2. AGREEMENT TO PERFORM NECESSARY ACTS. Each party hereto and the heirs, executors or administrators of the Shareholders shall

perform any further acts and execute and deliver any documents or procure any court orders which may reasonably be necessary to carry out the provisions of this Agreement.

14.3. ARBITRATION. Should there be any dispute concerning any provision hereof, the parties agree to submit the matter to an arbitrator before the Judicial Arbitration and Mediation Service ("JAMS") in Los Angeles, California, and to use their best efforts to obtain an expeditious resolution. The decision of the JAMS shall be final and binding and may be enforced by judgment upon application to a court of competent jurisdiction. Notwithstanding any rule of the JAMS to the contrary, California Civil Code Section 1283.05 shall dictate the rights of both parties to conduct discovery. The parties also agree that a restraining order maintaining the status quo and/or a writ of attachment may be obtained by any party pending the resolution of dispute from the JAMS. If, for any reason, JAMS refuses to hear and decide the question of imposition of a restraining order and/or a writ of attachment as herein contemplated, a party may then apply to a court of competent jurisdiction for the issuance of such an order. The arbitration shall then proceed in regards of all other issues and matters. The award must be based on, and accompanied by, a written statement of decision explaining the factual basis for the award as to each of the principal controverted issues at the hearing.

The award shall be confirmed and entered as a judgment by a competent court of jurisdiction in Los Angeles, California. The award may be appealed under the same standards specified in California law applicable to appeals from such a court.

14.4. ATTORNEYS' FEES. Should any dispute arise between the parties to this Agreement regarding the rights, remedies or relief afforded by this Agreement, then in addition to the relief the prevailing party may be awarded by a court or arbitrator, that party shall also be entitled to reasonable attorneys' fees incurred by him.

14.5. MODIFICATION. Except as otherwise provided herein, this Agreement may not be modified or amended except by a writing signed by the Shareholders holding a majority of the Shares and by an officer duly authorized to act on behalf of the Company. Notwithstanding the foregoing, the provisions of Sections 3.03 and 3.04 hereof may not be amended except by a writing signed by the parties then entitled to terminate this Agreement.

14.6. COUNTERPARTS. This Agreement may be executed in multiple counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

14.7. TESTAMENTARY PROVISIONS. Each Shareholder shall include in his or her will a direction and authorization to his or her executor to fulfill and comply with the provisions hereof, and to sell the Shares in accordance herewith.

14.8. SEVERABILITY. Each provision and part thereof this Agreement is intended to be severable and if any term or all or part of any provision hereof is held by judicial decision to be invalid, such invalidity shall not effect the validity of the remainder of this Agreement.

14.9. ENTIRE AGREEMENT. Agreement is intended by the parties hereto as a final expression of their agreement and understanding with respect to the subject matter hereof and as a complete and exclusive statement of the terms thereof and supersedes any and all prior and contemporary agreements and understandings.

14.10. GOVERNING LAW AND VENUE. This Agreement shall be construed, governed by, and interpreted in accordance with the. laws of the State of California, regardless of the laws that might otherwise govern under applicable principles of conflict of laws thereof. Any suit brought herein shall be brought in the state or federal court sitting in Los Angeles, California, the

parties hereto waiving any claim or defense that such forum is not convenient or proper. Each party hereby agrees that any such court shall have in personam jurisdiction over him and consents to service of process by any means authorized by California law.

14.11. ASSIGNS. This Agreement shall bind and inure to the benefit of the parties hereto and their respective heirs, executors, administrators, successors and assigns.

14.12. ADDITIONAL PARTIES. Future shareholders of the Company shall become parties to this Agreement by executing a counterpart hereof, whereupon each such signing person shall be bound by the terms and provisions hereof and entitled to the rights thereunder, as though such person had originally executed this Agreement.

IN WITNESS WHEREOF, the parties hereto have executed and signed this Agreement as of the date first written above.

By: JEANNE PIAUBERT

HOLDINGS, INC.,
a California corporation

/s/ Gary Hollister
Its: Executive Vice President

JEANNE PIAUBERT S.A.,
a French corporation,
27, rue Jean Goujon
75008 Paris, France

/s/ Jacques Konckier
By: Jacques Konckier
Its: President

/s/ Gary Hollister
Gary Hollister

/s/ Randy Sefrioui
Randy Sefrioui

/s/ Beverly Hollister

SCHEDULE A

SHAREHOLDERS OF THE COMPANY

	Name	Number of Shares of Common Stock Owned
1.	Jeanne Piaubert S.A.	667
2.	Gary Hollister	111
3.	Beverly Hollister	111
4.	Randy Sefrioui	111
	TOTAL	1000

EXHIBIT "G"

PROMISSORY NOTE

U.S. $5,000,000

Los Angeles, California
May 20, 1994

On or before July 1, 1999 (the "Maturity Date"), Jeanne Piaubert Cosmetics, LP ("Maker"), for value received, promises to pay to the order of Jeanne Piaubert S.A.. a French corporation ("Lender"), the sum of Five Million Dollars (U.S.$5,000,000), or if less, the aggregate unpaid principal amount of advances hereunder as shown either on the schedule attached hereto (and any continuation thereof) or in the records of Lender.

The unpaid principal amount hereof from time to time outstanding shall bear interest from the date hereof at the following rates per annum: (A) prior to maturity, at the rate of six percent (6%) per year; and (B) after maturity, whether by acceleration or otherwise until paid, at the rate of eleven percent (11%) per year. Interest shall accrue, but not be payable, until the Maturity Date. Accrued and unpaid interest shall be added to principal on the last business day of each calendar quarter and, after the Maturity Date shall bear like interest as principal. After the Maturity Date, whether by acceleration or otherwise, accrued interest shall be payable on demand.

All or any part of this note may be prepaid any time without penalty.

EXHIBIT "G"

No delay or omission on the part of Lender in exercising any right under this Note shall operate as a waiver of such right or of any other right hereunder. The waiver of any provision herein by Lender or the consent to any departure from any such provision (including, without limitation, the acceptance by Lender of any partial payment either before or after default or maturity) shall not be deemed a waiver of that or any other right at that time, nor a waiver of that or any other right subsequent thereto, but shall be applicable only in the specific instance or for the purpose for which such wavier or consent was given. No failure to accelerate the debt evidenced hereby by reason of default hereunder, acceptance of a past due installment, or indulgences granted from time to time shall be construed (i) as a novation of this Note or as a reinstatement of the indebtedness evidenced hereby or as a waiver of such right of acceleration or of the right of Lender thereafter to insist upon strict compliance with the terms of this Note, or (ii) to prevent the exercise of such right of acceleration or any other right granted hereunder or by applicable laws and Maker hereby expressly waives the benefit of any statute or rule of law or equity now provided, or which may hereafter be provided, which would produce a result contrary to or in conflict with the foregoing.

All payments in respect to this Note shall be made in lawful money of the United States America in same day funds at the office of Lender located at 27 Rue in Goujon, 75008 Paris, France, or at such other place as shall be designated in writing by Lender. The failure of the holder of this Note to make (or any error in the making of) a notation of any payment made on this Note shall not (i) limit or otherwise affect the obligation of Maker hereunder with respect to payments of principal or interest under this Note or (ii) subject the holder hereof to any liability whatsoever.

Maker agrees to pay all expenses, including reasonable attorneys' fees and legal expenses, incurred by the holder of this Note in endeavoring to collect any amounts payable hereunder which are not paid when due, whether by acceleration or otherwise, whether or not suit is actually instituted.

Maker hereby waives diligence, presentment, protest, demand for payment, notice of dishonor, and any and all other notices or demands of any kind in connection with the delivery, acceptance, performance, default, or enforcement of this Note, and hereby consents to any extensions of time, renewals, waivers or modifications that may be granted or consented to by the holder in respect to the time of payment or any other provisions of this Note, and to the full extent permitted by law, the right to plead any statute of limitations as a defense to any demand

hereunder. __Time is of the essence of each of the obligations of the undersigned hereunder.

This Note is made under and governed by the laws of the State of California without giving effect to conflict of law principles.. If any term or provisions of this Note shall be held invalid, illegal or unenforceable, the validity of all of the terms or provisions thereof shall in no way be affected thereby. This Note may not be changed, modified or terminated orally, but only by an agreement in writing signed by the undersigned and the Lender or Holder hereof.

JEANNE PIAUBERT COSMETICS, LP,
a California limited partnership

By: JEANNE PIAUBERT MANAGEMENT, INC., a California corporation

/s/ Beverly Hollister

By: Beverly Hollister
Its: President

LOANS AND PRINCIPAL PAYMENTS

Date Loan Made	Amount of Loan	Amount of Principal Repaid	Unpaid Principal Balance	Notation Made By
April 1994 (Bridge note)	$120,000	--		

LAW OFFICES OF GREGORY A. YATES
A PROFESSIONAL CORPORATION

GREGORY A. YATES (SBN 63259)
9454 Wilshire Blvd., Suite 850
Beverly Hills, CA 90212
(310) 858-6944

[FILED U.S. DISTRICT COURT 5/23/97 CENTRAL DISTRICT OF CALIFORNIA]

Attorneys for Plaintiffs Jeanne Piaubert, S.A. and Fragrance Group, Ltd.

UNITED STATES DISTRICT COURT
FOR THE CENTRAL DISTRICT OF CALIFORNIA

Jeanne- Piaubert, S.A., a Corporation, and CV97-Fragrance Group, Ltd., a Corporation,

Plaintiffs,

vs.

Randy Sefrioui, an Individual, Does 1 Through 20,

Defendants.

CASE No. 0327HLH

MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO DEFENDANT'S MOTION TO DISMISS PLAINTIFF'S FIRST

AMENDED
COMPLAINT
Date: June 9, 1997
Time: 10:00 a.m.
Place: Courtroom
of
Honorable Harry
L. Hupp

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Other Authorities

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Plaintiffs Jeanne Plaubert, S.A. ("JPSA") and Fragrance Group, Ltd. submit the following Memorandum of Points and Authorities in opposition to Defendant" s Motion to Dismiss Plaintiff 's First Amended Complaint.

I. PREFATORY STATEMENT.

Defendant's motion to dismiss should be denied. In the first claim for relief, Plaintiff JPSA has alleged its "purchase" of "stock" in Holdings. This stock falls within the literal definition of "security" set forth in the Exchange Act and possesses all of the common characteristics of stock.

The Supreme Court's decision in *Landreth Timber Co. v. Landreth,* 471 U.S. 681 [105 S.Ct. 2297, 85 L.Ed.2d 692] compels the conclusion that Defendant's fraud "in connection" with such transaction implicates the federal securities laws. In its first claim for relief, Plaintiff JPSA has also alleged its "purchase" of a "Note" from the Limited Partnership. This "Note" also falls within the literal definition of a "security" set forth in the Exchange Act. and Defendant has not met its burden of roof of demonstrating, as a matter of law that such Note falls within the categories of "notes" identified by the Supreme Court's decision in *Reves v. Ernst & Young*, 494 U.S. 56 *[I* IO S.Ct. 945, *2* 08 L.Ed.2d 47] (1990) as not constituting "securities."

In the second claim for relief, Plaintiff Fragrance Group has alleged its "purchase" of a limited partnership interest. Such limited partnership interest constitutes a "security" under the test enunciated in *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301[66 S.Ct. 1100, 1104, 90 L.Ed. 1244] (1946) as

applied by the Ninth Circuit. Contrary to Defendant's contention, Plaintiff Fragrance Group has alleced facts establishing the presence of the third prong of the *Williamson* test in that it has alleged facts establishing its lack of le al and actual control over the Limited Partnership and its dependence on the unique abilities of others.

Finally, despite the District Court's previous rejection of Defendant's arguments, Defendant continues to contend that Plaintiffs' claim under Corporate Code section 25504.1 is defective, that Plaintiff have failed to specifically identify any materially false representations by Defendant. that Plaintiffs' claims federal securities claims are barred by the one-year statute of limitations, and that

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Plaintiffs have failed to plead loss causation. The District Court should once again reject these spurious arguments.

II PLAINTIFF JPSA's ACQUISITION OF SHARES OF HOLDINGS CONSTITUTED THE "PURCHASE" OF A "SECURITY."

A. JPSA's ACQUISITION OF SHARES IN HOLDINGS CONSTITUTES A "PURCHASE" OF SECURITIES.

In paragraph 16 of Plaintiffs' first amended complaint, Plaintiff JPSA alleges that, in or about April 15, 1994, it acquired two-thirds of the shares of Jeanne, Piaubert

Holdings, Inc. as a result of Defendant's misrepresentations and omissions. Defendant contends that, because JPSA fails to allege that "it paid a nickel for those shares," there was no "purchase" by JPSA within the meaning of the Exchange Act. (Defendant's Memorandum, page 6, lines 12-14.) The District Court, which previously rejected this argument,[1] should reject it again.

15 U.S.C. section 78c(a)(I 3) provides:

> (13) The terms "buy" and "purchase"' each include any contract to buy, purchase or ***otherwise acquire***. (Emphasis added.)

Courts, in determining whether certain transactions involved a purchase or sale within the meaning of section 10(b) and Rule 10b-5, have found that the broad language of the statutory definitions in section 78c(a)(13) and (14) indicate a congressional intention that the words"purchase" and "sale" are not limited to transactions ordinarily governed by the commercial law of sales. *Dasho v. Susquehanna* (7th Cir. 1967) 380 F.2d 262, 266, *cert. denied* 389 U.S. 977.)[2]

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1 In its ruling granting Defendant's motion to dismiss Plaintiffs' original complaint with leave to amend, the District Court did not rule that plaintiff JPSA had failed to allege a "purchase," thereby implicitly rejecting such contention.

2 Thus, for example, it has been held that issuance by a corporation of its own securities constitutes a "sale" for purposes of anti-fraud provisions of section 10(b) and Rule 10b-5. (*Ruckle v. Roto American Corp.*, (2d Cir. 1964) 339 F.2d 24, 27; *Rekant v. Desser* (5th Cir. 1970) 425 F.2d 872, 877-878).

Nothing in the language of section 78c(a)(13) requires that a person acquiring a security must pay "a nickel" in order for the protection of section 10(b) and Rule 10b-5 to apply. Moreover, even if this requirement existed, JPSA has specifically alleged that, about the time it acquired shares in

Holdings, it "caused $120,000 in initial start-up funding for the new business venture to be sent to a bank account in the United States that Sefrioui and the Hollisters controlled and from which they were able to make withdrawals" and that "[JPSA's] funding continued throughout the remainder of 1994 and totaled $980,000 by the end of that year." (Complaint,'@ 20.) Thus, even assuming JPSA must allege the passing of consideration between JPSA and Holdings, which JPSA disputes JPSA has sufficiently alleged such consideration.

If the Court believes that Plaintiff JPSA has not sufficiently alleged the "purchase," of its stock, JPSA should be given the opportunity to amend its complaint.

B. JPSA HAS ALLEGED THE PURCHASE OF "SECURITIES."

1. The Stock Acquired by JPSA in Holdings Falls Within the Express Definition of

"Security" and Bears the Usual Characteristics of Stock.

15 U.S.C. section 78c(10) defines the term "security." Included in this definition is "any. . .stock. . ."
Defendant does not, and cannot, dispute that the stock interest acquired by Plaintiff JPSA in Holdings falls within the literal definition of "security" ' the 1934 Act. Rather, Defendant contends that because Plaintiff JPSA retained control of Holdings by virtue of its ownership of two-thirds of its shares, and because the agreement by which JPSA acquired such shares was privately negotiated, the Exchange Act does not apply. In *Landreth Timber Co. v. Landreth*, 471 U.S. 681[105 S.Ct. 2297, 85 L.Ed.2d 692], however, the Supreme Court rejected identical arguments and held that, where the stock in dispute bore the usual characteristics of "stock," the fact that the party acquiring the stock controlled the, company and that such acquisition was the result of a privately negotiated transaction, did not preclude the application of the Exchange Act.

In *Landreth*, the defendants father and sons, who owned all of the common stock of a lumber business that their operated, offered their stock for sale through brokers. The company's sawmill was subsequently damaged by fire, but potential purchasers were told that the mill would be rebuilt and modernized. Thereafter, a stock purchase agreement for all of the stock was executed, and ultimately a company was formed by the purchasers. After the acquisition was completed, the, mill did not live up to the purchasers'

expectations. Eventually, the plaintiff sold the mill at a loss and went into receivership. The plaintiff then filed suit in Federal District Court for rescission of the sale of stock

and damages, alleging that defendants had violated the registration provisions of the Securities Act of 1933 and the antifraud provisions of the Securities Exchange Act of 1934.

The district court granted summary judgment for defendants, ruling that the stock could not be considered a "security." Finding, that managerial control of the business had passed into the hands of the purchasers, and thus that the transaction was a commercial venture rather than a typical investment, the district Court dismissed. the complaint. The Court of Appeals for the Ninth Circuit affirmed.

The Supreme Court began its analysis by reviewing the applicable statutory language defining "security" and concluded that "[t]he face of the definition shows that 'stock' is considered to be a 'security' within the meaning of the Acts. (*Id.*, 471 U.S. at 686.) The Court went on to hold that where the stock in question bore stock's usual characteristics, the securities laws applied:

> As we also recognized in *Forman [United Housing Foundation, Inc. v. Forman,* 421 U.S. 837 (1975)], the fact that instruments bear the label "stock" is not of itself sufficient to invoke the coverage of the Acts. Rather, we concluded that we must also determine whether those instruments possess "some

of the significant characteristics typically associated with" stock, id., at 851, **recognizing that when an instrument is both called "stock" and bears stock's usual characteristics, "a purchaser justifiably [may] assume that the federal securities laws apply,"** id., at 850. We identified those characteristics usually associated with common stock as (i) the right to receive dividends contingent upon an apportionment of profits; (ii) negotiability; (iii) the ability to be, pledged or hypothecated; (iv) the conferring of voting rights in proportion to the number of shares owned; and (v) the capacity to appreciate in value. *Id.*, at 851 *(Id.*, 471 U.S. at 686 (footnote omitted) (emphasis added).).

In this case, Plaintiff JPSA has alleged that the stock interest it acquired in Holdings bore stock's usual characteristics:

16.... These shares of stock bore the usual characteristics of "stock" as that term is commonly understood in that the holder of 'the stock (1) had the right to

receive dividends contingent upon an apportionment of profits; (ii) the stock was transferable; (iii) the stock could be pledged or hypothecated; (lv) the

stock conferred voting rights in proportion to the number of shares owned, and (iv) the stock had a capacity to appreciate in value. (Complaint, ¶16.)

Thus, there is no question that JPSA's acquisition of shares of stock in Holdings involved the purchase of "securities."

2. **The Fact That JPSA Retained "Control" over Holdings by virtue of its Two-thirds Stock Interest Is Irrelevant to the Issue of Whether such Stock Constitutes "Securities."**

In *Landreth*, the defendants' contended that whether the stock was a "security" for purposes of the federal securities laws depended on the economic substance of the transaction, regardless of whether the instrument in dispute fell within the literal definition of "security." The Supreme Court rejected such contention, holding that there was no need to look beyond the characteristics of the instrument to determine whether the securities laws applied:

> Respondents contend that *Forman* and the cases on which it was based require us to reject the view that the shares of stock at issue here may be considered "securities" because of their name and characteristics. Instead, they argue that our cases require us in every instance to look to the economic substance of the transaction to determine whether the *Howey* test has been met. According to respondents, it is clear that petitioner sought not to

earn profits from the efforts of others, but to buy a company that it could manage and control. Petitioner was not a passive investor of the kind Congress intended the Acts to protect, but an active entrepreneur, who sought to "use or consume" the business purchased just as the purchasers in *Forman* sought to use the apartments they acquired after purchasing shares of stock. Thus, respondents urge that the Acts do not apply.

We disagree with respondents' interpretation of our cases. First, it is important to understand the contexts within which these cases were decided. All of the cases on which respondents rely involved unusual instruments not easily

characterized as "securities." Set n. 4, supra. Thus, if the Acts were to apply in those cases at all, it would have to have been because the economic reality underlying the transactions indicated that the instruments were actually of a type that falls within the usual concept of a security. ***In the case at bar, in contrast, the instrument involved is traditional stock, plainly within the statutory definition. There is no need here, as there was in the prior cases, to look beyond the characteristics of the***

instrument to determine whether the Acts apply. *(Id.,* 471 U.S. at 689-690 *(emphasis added).)*

The Court also rejected defendants' contention that the *Howey* test had to be met regardless of whether the instrument fell within the literal definition of "security:"

> Second, we would note that the *Howey* economic reality test was designed to determine whether a. particular instrument is an "investment contract," not whether it fits within any of the, examples listed in the statutory definition of "security," Our cases are consistent with this view. *Teamsters v. Daniel,* 439 U.S., at 558 (appropriate, to turn to the *Howey* test to "determine whether a particular financial relationship constitutes an investment contract"); *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837 (1975); *see supra,* at 689. Moreover, applying the *Howey* test to traditional stock and all other types of instruments listed in the statutory definition would make the Acts' enumeration of many types of instruments superfluous. *Golden v. Garofalo,* 678 F.2d 113 9, 1144 (CA2 1982). See *Tcherepnin v. Knight,* 389 U.S. 332, 343 (1967), *(Id.,* 471 U.S. at 691-692.)

Finally, the Court rejected the identical argument made by Defendant in this case, i.e., that the securities laws were only intended to cover "passive investors"' and not privately negotiated transactions involved the transfer of control to "entrepreneurs:"

> ***Finally, we cannot agree with respondents that the Acts were intended to cover only "passive investors" and not privately negotiated transactions involving the transfer of control to "entrepreneurs."*** The 1934 Act contains several provisions specifically governing tender offers, disclosure of transactions by corporate officers and principal stockholders, and the recovery of short-swing profits

gained by such persons. *See, e.g.,* 1934 Act, §§ 14, 16, 15 U. S. C. §§ 78n, 78p. Eliminating from the definition of "security" instruments involved in transactions where control passed to the purchaser would contravene the purposes of these provisions. *Accord, Daily v. Morgan,* 701 F.2d 496, 503 (CA5 1983). Furthermore, although § 4(2) of the 1933 Act, 15 U. S. C. § 77d(2), exempts transactions not involving any public offering from the Act's registration provisions, there is no comparable exemption from the antifraud provisions. Thus, the structure and language of the Acts refute respondents' position. *(Id.,* 471 U.S, at 692.) (Emphasis added.)

III. THE PROMISSORY NOTE ACQUIRED BY JPSA FROM THE LIMITED PARTNERSHIP IS A SECURITY.

In paragraph 18 of the first amended complaint, Plaintiff JPSA alleges that it acquired a $5 million "note" from the Limited Partnership in return for the transfer of $5 million. The application of the Supreme Court's holding in Reves v. Ernst & Young, 494U.S.56[110 S.Ct. 945, 108 L.Ed.2d 47] (1990) to the facts of this case requires a finding that such note is a "security."

In *Reves*, the Court was confronted with the issue of whether demand notes issued by an agricultural cooperative in order to raise money to support its general business operations constituted "securities" for purposes of the Exchange Act. In that case, the defendant Co-Op, in order to raise money to support its general business operations, sold uncollateralized and uninsured promissory notes payable on demand by the holder. After the Co-Op filed for bankruptcy, the plaintiffs, holders of the notes, filed suit in the District Court against the Co-Op's auditor, alleging, *inter- alia,* that it had violated the antifraud provisions of the Securities Exchange Act of 1934 and Arkansas' securities laws by intentionally failing to follow generally accepted accounting principles that would have made the Co-Op's insolvency apparent to potential note purchasers.

The plaintiffs prevailed at trial, but the Court of Appeals reversed. Applying the test created in *SEC v. W.J. Howey Co.*, 328 U.S. 293, the Eight Circuit held that the notes were not securities under the 1934 Act or Arkansas law and that the statutes' antifraud provisions therefore did not apply.

The Supreme Court began Its analysis by examining the language of section 3(a)(10) of the 1934 Act, which defines the term "security" The Court observed that because the Securities Acts define "security" to include "any note," there was a presumption that every note is a security. *(Id.,* 494 U.S. at 65.) After observing that the Circuits had applied varying tests to determine whether a note was a security,[3] the Court adopted the "family resemblance" test adopted by the Second Circuit and held:

> We conclude, then, that in determining, whether an instrument denominated a "note" is a "security" courts are to apply the version of the "family resemblance" test that we have articulated here: A note is presumed to be a "security" and that presumption may be rebutted only by a showing that the note bears a strong resemblance (in terms of the four factors we have identified) to one of the enumerated categories of instrument. If an instrument is not sufficiently similar to an item on the list, the decision whether another category should be added is to be made by examining the same factors. (*Id.*, 494 U.S. at 67.)

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3 Among these tests were the "investment versus commercial" approach and the *Howey* test. The Court specifically rejected the application of the *Howey* test to the determination of whether a note was a security. (*Id.*, 494 U.S. at 64.)

These enumerated categories of instrument were identified by the Court as follows:

> "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a 'character' loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply realizes an open-account debt incurred in the ordinary course of business (particularly if, as in the ease of the customer of a broker, it is collateralized)"); *Chemical Bank, supra,* at 939 (adding to list "notes evidencing loans by commercial banks for current operations"). (Id., 494 U.S. at 67.)

Noting that there was a presumption that any note with a term greater than nine months was a "security," the court concluded that such presumption did not apply because the note was payable on demand. and that the plaintiff therefore had the burden of demonstrating that the note was a security. (760 F.Supp. at 324.)[4] The district court went on to conclude that, based on the economic reality implicit in the facts of the

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4 In this case, on the other hand, the Note form the Limited Partnership to JPSA was for a term of five years. Thus, there is a presumption that the Note was a security, and Defendant bears the burden of proving that the Note is not a "security".

case, "the note was drafted as a means of recording open account loans made by plaintiff and for tax purposes" and was therefore not a security (Id., 760 F.Supp at 325.)

Unlike the series of loans in *Varnberg*, the Note alleged by Plaintiff JPSA was given in return for a $5 million loan which was used. "to raise money for the general use of the Limited Partnership and/or to finance substantial investments, and JPSA was interested. primarily in the profit the Note was expected to generate." (First Amended Complaint, ¶18.) Thus, Plaintiff has alleged that the Note was intended to be an investment,[5] and has not alleged facts which demonstrate as a matter of law that the Note "simply formalized an open-account debt incurred in the ordinary course of business." *(Reves,* 494 U.S. at 66.)

Under Federal Rule of Civil Procedure 12(b)(6), the court will grant a motion to dismiss only when it appears beyond doubt that plaintiffs can prove no set of facts in

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5 In *Reves*, the Court also observed that "Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called." (*Id.*, 494 U.S. at 61.) Since Plaintiff JPSA has alleged that the Note was intended to be an investment, the Court's holding in *Reves* requires a finding that the Note was intended to be an investment, the Court's holding in *Reves* requires a finding that the Note was a "security" protected by the securities laws. (*See also Exchange National Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1137-38 (2d Cir. 1976) (unsecured subordinated "promissory notes" issued by brokerage firm as part of a large financing operation and payable on certain dates upon written demand are "securities" subject to section 10(b).)

support of their claim which would entitle them to relief *(Moore v. City of Costa Mesa.,* 886 F.2d 260, 262 (9th Cir. 1989).) In reviewing a motion to dismiss the court must accept as true all material allegations in the complaint, as well as reasonable inferences to be drawn from them. (Id.) Thus, Defendant's factually unsubstantiated conclusion that Plaintiff "simply funded a start-up venture which they and Bogart

created and controlled" and that "[f]unding took the form of periodic advances in the nature of an open book account for operating purposes"[6] cannot be appropriately considered in connection with this motion. At a minimum, there is an issue of fact whether the Note is a "security."

Defendant's reliance on *Tab Partnership v. Grandland Fin. Corp.*, 866 F.Supp. 807 (S.D.N.Y. 1994) is similarly misplaced. In that case, the district court relied on the Supreme Court's decision in *Marine Bank v. Weaver*, 455 U.S. 551, 560 [102 S. Ct. 1220, 1225, 71 L. Ed. 2d 409, 417] (1982), for the proposition that an agreement is not a security if the defendants "distributed no prospectus to the [plaintiffs] or to other potential investors," the agreement they negotiated "was not designed to be traded publicly," and the agreement was negotiated one-on-one between the parties.

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6 Defendant's Memorandum, page 14, lines 13-15.

(Id., 866 F.Supp. at 809.) The district court's, holding that the "agreement" at issue in that case was not a "security" was predicated on its conclusion that, "the agreement in this action was arrived at through one-on-one negotiation and that plaintiffs did not allege that the agreement would be traded publicly or that a prospectus would be Distributed (Id.) The instruments in dispute in *Marine Bank v.* however, were not notes, but a Certificate of Deposit issued by a federally, regulated bank and a business agreement between two families under the terms of which one family guaranteed a bank loan by the other family in return for their right to receive 5O% of the net profits and $l00 per month from the other family's company. The Court held that a certificate of deposit did not fall within the literal definition of a "security" and that there were important differences between a certificate of deposit purchased from a federally regulated bank and other long-term debt obligations. The Court also noted that the purchase of a certificate of deposit was virtually Guaranteed payment in full, whereas the holder of an ordinary long-term debt obligation assumed the risk of the borrower's insolvency. (Id., at 455 U.S. at 558.) Finally, the Court concluded that "it is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provision of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws." (Id.)

In this case. on the other hand, Plaintiff JPSA was not Guaranteed payment in full of the Note and assumed the risk

of the Limited Partnership's insolvency. Moreover, there is no other regulatory

scheme that reduced the risk of the Note, thereby rendering application of the securities laws necessary. In *Reves,* the Court recognized this latter factor as Important in determining whether a note should be deemed a security. (Id., 494 U.S. at 67.) Moreover, nowhere in *Reves* did the Supreme Court identity, as a relevant consideration whether a note was "arrived at through one-on-one negotiation."

Under the Supreme Court's decision in *Reves,* the Note acquired by JPSA from the Limited Partnership is presumptively a "security." Defendant has failed to meet its burden of establishing, ***as a matter of law"*** that such Note bears a strong resemblance in terms of the four factors identified in *Reves,* to a note "which simply formalizes an open-account debt incurred in the ordinary course of business." (Id., 494 U.S. at 65.)

IV. PLAINTIFF FRAGRANCE GROUP's LIMITED PARTNERSHIP IS A SECURITY.

In paragraph 17, Plaintiff Fragrance Group alleges that it acquired a limited partnership interest in Jeanne Piaubert Cosmetics LP ("Limited Partnership"). In the Second Claim

for Relief. Plaintiff Fragrance Group alleges that this limited partnership interest was a "security" and that it was defrauded by Defendant in connection with its purchase of such security. (First Amended Complaint, ¶34.)

Included in the definition of "security" under 15 U.S.C. section 78c(l0) is a "certificate of interest or participation in any profit-sharing agreement [and] investment contract . . ." Because limited partnership interests do not fall within the literal definition of a "security" courts in determining whether limited partnership interests are securities have applied the *Howey* analysis in determining whether such interests are "investment contracts." In *Howey,* the Supreme Court defined an "investment contract" as follows:

> an investment contract for purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party *(Id.,* ')28 U.S. at 298-299.)

Defendant does not dispute that the first two elements of the *Howey* test are met in this case, i.e., an "investment in a common enterprise" with "the expectation of profits." Rather, Defendant contends that the third element is absent.

In *Williamson v. Tucker,* 645 F.2d 404, 424 (5th Cir. 1981) *cert. denied,* 454 U.S. 897, 102 S.Ct@ 397, the court held that, to establish the third prong of the *Howey* test, an investor must establish:

> "(1) an agreement among the parties leaves so little power in the hands of the partner or venturer that the arrangement in fact distributes power as would a limited partnership; (2) the partner or venturer is so inexperienced and unknowledgeable in business affairs that he is incapable of intelligently exercising his partnership or venture powers; or (3) the partner or venturer is so dependent on some unique entrepreneurial or managerial ability of the promotor or manager that he cannot replace the manager of the, enterprise or otherwise exercise meaningful partnership or venture powers." *(Id., 645* F.2d at 424.)

In the First Amended Complaint, Plaintiff Fragrance Group alleged facts sufficient to establish the first and third prongs of the *Williamson* control test.

17.... Plaintiff FG Limited's investment was an investment in a common venture promised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others, i.e., Sefrioui and the Hollisters. These efforts were the undeniably significant ones, i.e., those essential managerial efforts which affected the failure or success of the enterprise. ***Under California law and under***

the terms of the limited partnership agreement, Plaintiff, as a limited partner, did riot have the ability to control the operations of the limited partnership. The Defendants and the Hollisters controlled the day to day operations of the limited partnership. ***In addition, the Hollisters possessed unique entrepreneurial and/or managerial skills and abilities in connection with the operation of the franchising business, and Plaintiff was so dependent on the unique entrepreneurial and/or mangerial abilities of the Hollisters that it could not***

replace the Hollisters or otherwise exercise meaningful control over the Limited Partnership. (Emphasis added.)

Under California law, a limited partner, such as Plaintiff Fragrance Group, cannot exercise control over the operations of the limited partnership and. remain a limited partner. Indeed, the Ninth Circuit has held that limited partnership interests are generally "securities:"

> "Under the test for an investment contract established in *S.E.C. v. W.J Howey Co.*, 328 U.S, 293, 301, 66 S.Ct. 1100, 1104, 90 L.Ed. 1244 (1946), a limited partnership generally is a security [citations] because by definition, it involves investment in a common enterprise with. profits to come solely from. the efforts of others." (*SEC v. Murphy*, (1990) 626 F.2d 633, 640.)

Indeed, the Limited Partnership Agreement attached as Exhibit C to Defendant's motion specifically provides that "the Limited Partners shall not have any right or power to take part in the management or control of the Partnership or its business and affairs or to act for or bind the Partnership in any way." (Section 6.1)

The fact that Plaintiff JPSA had an ownership interest in the parent corporation of the general partner of the Limited Partnership does not require a finding that Plaintiff Fragrance Group's limited

partnership interest in the Limited Partnership is not a security. In *Hirsch v. DuPont,* 396 F.Supp. 1214 (S.D.N.Y. 1975), *aff'd* 553 F.2d 750 (2d Cir. 1977), the court held that a limited partnership interest constituted a security even where, there was an accompanying general partnership interest. In that case, the plaintiffs had purchased both limited and general partnership interests in the DuPont Company. Later, plaintiffs believed that they had been defrauded into paying too much for their interests and sued under the federal securities acts. Defendants argued that the plaintiffs' right to actively share in the management of the corporation negated any claimed interest in securities. The court disagreed, holding that plaintiffs" limited partnership interests could be considered separately from the general partnership interests purchased at the same time. The court concluded that these limited partnership shares were securities, "because limited partners must, by statute, rely

solely on the efforts of others for their profit." (396 F.Supp. at 1228.)

In *Rodeo v. Gillrnan* (7thCir. 1986) 787F.2d 1175, 1178, the court held that even where the plaintiff limited partners had the night to acquire a general partnership interest, the limited partnership interest was still a "security".

Defendant's reliance on *Frazier v. Manson*, (D.C. Tex. 1980) 484 F.Supp. 449, *aff'd* 651 F.2d 1078 is misplaces. In that case, the plaintiff was a general partner who had acquired limited partnerships interests in various Iii3aited partnerships. The court found that the first two prongs of the *Howey* "investment contract" test were met in that the plaintiff had "invested money" in a common enterprise with the expectation of receiving profits. The court went on to find that the plaintiff had provided managerial services to the limited partnerships and had the right to participate actively in the daily business operations of the general partner and the limited partnerships, (Id., 484 F.Supp. at 452.)

In both *Power Petroleums, Inc. v. P&G Mining Co.*, 682 F.Supp. 492 (D.Colo. 1988) and in *Holden v. Hagopian*, 978 F.2d 1115 (9th Cir. 1992), the interests in question were ***general*** partnership interests, not a limited partnership interests, and in both cases, the plaintiff retained control over the partnership.

On this case, on the other hand, there are no facts alleged in the First Amended Complaint which establish as a matter of law that ***Fragrance Group*** had the legal ability or in fact exercised any control over the operations of the Limited Partnership or that ***Fragrance Group*** was anything other than a passive investor in Limited Partnership.[7]

Defendant's contention that Plaintiff Fragrance Group cannot meet the third prong of the *Williamson* control test because it has not alleged that it was dependent on any unique ability of Sefrioui is without merit. *Williamson* only holds that a plaintiff must allege its dependence "on some unique entrepreneurial or managerial ability of the promotor or manager that he cannot replace the manager of the enterprise or otherwise exercise meaningful partnership or venture powers." (*Id.*, 645 F.2d at 424.) Plaintiff Fragrance Group has alleged such dependence on the Hollisters. (See ¶ 17.)

Since, from the facts alleged, it is clear that the limited partnership interest acquired by Plaintiff Fragrance Group is a "security" the fact that the transaction pursuant to which

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7 Throughout his Memorandum, Defendant lumps Plaintiff JPSA and Plaintiff Fragrance Group together and refers to a "Venture." In their complaint, however, Plaintiffs refer to specific instruments which form the basis of their securities laws claim. These instruments, not the "Venture" referred to by Defendant are the proper focus of the court's attention.

such limited partnership interest was acquired was "privately negotiated" is irrelevant. Indeed, courts have recognized the applicability of securities fraud claims involving "private" transactions involving limited partnership agreements. *(See, e.g., Rodeo v. Gillman, supra; Hirsch v. DuPont, supra.)*

The facts in *Mace Neufeld Productions, Inc. v. Orion Pictures Corporation*, (9th Cir. 1988) 860 F.2d 944, cited by Defendant, are inapposite. In that case, the plaintiff, who had been producing the television series "Cagney and Lacey" had entered into a written contract with Orion Pictures and a television producer pursuant to which they agreed to assume the production of the show from the plaintiff and the plaintiff was to invest cash and expected future compensation with the series enterprise in return for a net profit participation in the series, *inter alia*. The plaintiff filed suit in federal district court contending that the defendants had violated this contract and claimed that the defendants had violated federal securities laws because the contract was an "investment contract," and therefore a "security" within the meaning of the Securities Exchange Act of 1934. The district court dismissed the federal securities claim under Rule 12(b)(6) and the Ninth Circuit affirmed. holding that the "private agreement, negotiated directly and individually by the parties, is not a security." (*Id.*, at 946.)

Nowhere in its opinion did the Ninth Circuit hold that a limited partnership interest in a company did. not constitute a "security" for purposes of the 1934 Act if the transaction pursuant to which such "security" was purchased or sold was

privately negotiated. Indeed, the court impliedly recognized that, had the parties formed a limited partnership agreement in that case and the plaintiff been issued a limited partnership interest, such interest would have been constituted a "security." *(Id.,* 860 F.2d at 946, fn 4.)

V. THE FACT THAT DEFENDANT WAS NOT A "SELLER" OF THE SECURITIES DOES NOT RELIEVE DEFENDANT OF LIABILITY IMPOSED BY CORPORATION CODE SECTION 25504.1.

Defendant's argument that Defendant cannot be liable under Corporation Code section 25504.1 for materially assisting in the violation of section 25401 because Defendant was not a "seller" should be rejected again by the District Court.

Section 25504.1 provides in pertinent part:

Any person who materially assists in any violation of Section . . . 25401. . . with intent to deceive or defraud, is jointly and severally liable with any other person liable under this chapter for such violation.[8] (Emphasis added.)

8California Corporation Code section 25401 provides: It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security

Thus, contrary to Defendant's contention, the fact that Defendant was not a "seller" of the securities at issue does not insulate him from liability for his actions in "materially assisting" in the actions which violate section 25401. Plaintiffs, have alleged sufficient facts to establish that Defendant materially assisted. in the sale of securities to Plaintiff through the use of fraudulent statements and omissions.[9] Plaintiffs have therefore alleged facts sufficient to establish Defendant's liability under section 25504.1

The court decision in *Empl. Ins. Of Wausau v. Musick, Peeler & Garrett,* 871 F.Supp. 381, 387 (S.D.Cal. 1994) is inapposite. In that case, the insurers who paid out a $13 million settlement in the Cousins Home Furnishings, Inc. securities litigation in the late 1980's brought an action for contribution and equitable indemnity against attorneys and accountants who were not named as defendants in the

---

> in this state by means of any written or oral communication which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

9"41. Defendants and the Hollisters materially assisted in the offering or sale of securities to Plaintiffs by means of a written or oral communication which included an untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading with the intent to deceive or defraud Plaintiffs in violation of California Corporation Code sections 25401 and 25504.1"

Cousins action. The insurers claimed that the attorneys and accountants were joint tortfeasors along with the parties that they insured and on whose behalf they paid the settlement amount. Included among the insurers claims were claims under Corporation Code sections 25504.1 and 25504.2. The defendants moved to dismiss the claims, contending that the complaint did not

sufficiently plead privity between the subrogors (the insureds) and the stock purchasers. The district court granted the motion with leave to amend, holding:

> [T]he question is whether the complaint pleads privity between the insureds and the purchasers. Nowhere does the complaint state that the insureds were the persons who directly sold the securities to the investors. The 10th, 11th and 16th claims are dismissed, without prejudice.

In this case, Plaintiffs have alleged privity between them and the entities from which they purchased the securities: Holdings and the Limited Partnership.

VI. PLAINTIFFS HAVE ALLEGED FACTS SUFFICIENT TO DEMONSTRATE CAUSATION ENTITLING THEM TO

RELIEF UNDER FEDERAL SECURITIES LAWS.

Although the District Court rejected such contention in connection with Defendant's first motion to dismiss, Defendant continues to assert that Plaintiffs have failed to alleged "loss" causation. Defendant's argument should be rejected again.

Plaintiffs have alleged that, as a result of Defendant's fraudulent misrepresentations and wrongful conduct, they entered into certain transactions with Defendant and invested over $5 million in cash and over $961,000 worth of cosmetics inventory on credit. (Complaint, ¶21.) Both JPSA and Fragrance Group allege that they suffered damages as a result of Defendant's wrongful acts.[10] Contrary to Defendant's contentions, these allegations are sufficient to allege "loss" causation, *i.e.*, that Plaintiffs sustained economic loss as a result of Defendant's fraud.

Defendant's contention that "Plaintiffs cannot show a direct nexus between Sefrioui's alleged representations and

---

10In paragraph 30, Plaintiff JPSA alleges: "As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above, Plaintiff has suffered damages in excess of $6.5 million."

In paragraph 39, Plaintiff Fragrance Group alleges: "As a direct and proximate result of the acts, omissions and non-disclosures of the Defendants and the Hollisters alleged above, Plaintiff has suffered damages in excess of $75,000."

any decline in value in any investment,"[11] implies that Plaintiff must allege such direct nexus. Of course, Defendant cites no authority for this proposition. In fact, the law is clear

that when a person is defrauded into entering into a transaction, he may recover the difference between the price paid and the real or actual value at the time of acquisition, ***together with those consequential damages that resulted from the fraud.*** *(Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (9th Cir. 1981) 651 F.2d 615, 620; *Grubb v. Federal Deposit Ins. Corp.* (10th Cir. 1989) 868 F.2d 1151, 1165 (consequential damages in form of additional capital contributions by plaintiff to defendant baffle recoverable if proved to be related to seller's misrepresentation.)

In this case, Plaintiffs have alleged sufficient facts to establish that they both invested money in securities that they had been fraudulently induced to acquire by Defendant and that they were damaged as a proximate result of such fraud. These allegations are sufficient allegations of damages caused by Defendant's fraud.

11Defendant's Memorandum, page 17, lines 21-22.

VII. PLAINTIFF'S FEDERAL SECURITIES CLAIMS ARE NOT BARRED BY THE STATUTE OF LIMITATIONS.

Defendant asserts the identical statute of limitation argument that was rejected by the District Court in connection with its motion to dismiss Plaintiffs original complaint. Defendant's argument should be rejected again.

As the Ninth Circuit has previously stated regarding the accrual of a cause of action under the securities laws and common law fraud: "Even if the partes' alternate interpretations were doubtful, the question of what a reasonable investor would have done is not so certain as to allow a determination as a matter of law." *(General Bedding Corp. v. Echevarria* (9th Cir. 1991), citing *SEC v. Seaboard Corp.* (9th Cir. 1982) 677 F.2d 1301, 1310.) Where there are "murky" issues surrounding the tolling of the statute of limitations and notice of the fraud, a motion to dismiss based on the statute of limitations will be denied. (*Newman v. Comprehensive Care Corp.* (D.Ore. 1992) 794 F.Supp. 1513, 1522.)

In paragraph 29 of the First Amended Complaint, Plaintiffs allege:

> "29. Plaintiff did not discover the falsity of Sefrioui's representations, and did not have knowledge of any facts which would haze caused a reasonable person to investigate the representations of Sefrioui, until the fall of 1996."

Notwithstanding this clear allegation that Plaintiffs discovered the fraudulent nature of Defendant's representations within a year of the filing of this action, Defendant argues that, because Plaintiffs did not open 120 stores in the first year of operation (May 1994 - May 1995), Plaintiff necessarily had notice that the opening of 120 stores in the first year of operation was not "achievable" and, therefore, Plaintiff should have been aware that Defendant had committed a fraud upon Plaintiffs, This contention is without merit.

The fact that Defendant was unable to open the projected number of stores in the first year of operation did not necessarily mean that his projections were not "realistic, reachable, achievable and doable," and certainly did not put Plaintiffs on notice as a matter of law that Defendant had defrauded them.

As Plaintiffs allege, it was only within a year from the filing of their complaint that they became aware that Defendant's projections for beginning a retail franchise in the United States would not have been achieved, regardless of any circumstances, because they were not realistic.

In addition, Defendant does not dispute Plaintiffs' allegation that Plaintiffs discovered Defendant's fraud with respect to his background and experience more than a year prior to filing this action. These fraudulent representations are sufficient to sustain Plaintiffs' federal securities claims

independent of Defendant's representations regarding the number of stores that could be opened during the first year.

VIII. PLAINTIFFS HAVE SUFFICIENTLY ALLEGED THE FALSITY OF DEFENDANT'S REPRESENTATIONS.

Defendant renews its meritless contention, already rejected once by the District Court, that Plaintiffs have not adequately alleged the falsity of Defendant's representations with sufficient particularity. In paragraph 23, Plaintiffs allege that these representations were false and why they were false:

> 23. The representations described above were false and/or misleading. The true facts were as follows:
>
> A. Sefrioui did not have the educational or employment background that he had represented, did not have the level of experience working for

> McKinsey & Co. that he claimed to have had, had not worked for a number of companies that specialized in drafting Business Plans for retail franchise start-up businesses, had not implemented such Business Plans successfully on a large scale in the United States market, and was not capable and

sufficiently experienced to draft realistic Business Plans for the development of a retail cosmetics franchising business in the United States or to implement them successfully.

B . The representations concerning the Hollisters' background were misleading in that the Hollisters' failed to disclose that they had been terminated from their employment at Merle Norman Cosmetics, and that the Hollisters otherwise overstated and misrepresented the extent of their background, experience and level of responsibility.

C. The great majority of the Merle Norman franchise stores had been opened prior to G. Hollister's employment with Merle Norman Cosmetics, G. Hollister had never been personally responsible for the opening of 300 stores in a year, the Merle Norman Cosmetics Franchising business was not going to close down in the near future, G. Hollister could not sell Jeanne Piaubert Cosmetics franchises to a large number of persons who had previously bought Merle Norman Cosmetics franchises, and that G. Hollister would not be able to bring in $50 million per year in annual revenue from the Merle Norman franchise store owners to the new United States franchising business or Jeanne Piaubert Cosmetics.

Thus, Plaintiffs have sufficiently alleged the falsity of Defendant's representations.

IX. CONCLUSION.

For the foregoing reasons, Defendant's motion to dismiss should be denied in its entirety.

DATED: MAY 21,1997 LAW OFFICES OF GREGORY A. YATES

B Y: /S/
GREGORY A. YATES
ATTORNEYS FOR PLAINTIFFS
JEANNE PIAUBERT, S.A. AND
FRAGRANCE GROUP, LTD.

PROOF OF SERVICE

STATE OF CALIFORNIA)

)

COUNTY OF LOS ANGELES)

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is 9454 Wilshire Boulevard, #850 Beverly Hills, California 90212.

On May 22, 1997, I served the foregoing document described as **MEMORANDUM OF POINTS AND AUTHORITIES IN OPPOSITION TO DEFENDANTS MOTION TO DISMISS PLAINTIFF'S FIRST AMENDED COMPLAINT,** *on all parties in this action by placing:*

/___/the original /x/ a true copy thereof enclosed in a sealed envelope addressed as follows:

ROBERT G. CAMPBELL, ESQ.
THELEN, MARTIN, JOHNSON & BRIDGES
333 SOUTH GRAND, SUITE #3400
LOS ANGELES, CA 90071-3193

/__/ the original /X/ a true copy thereof enclosed in a sealed envelope addressed as follows:

KENNETH NATHANSON, ESQ.
SHERMAN, NATHANSON & MILLER
9454 WILSHIRE BLVD., #820
BEVERLY HILLS, CA 90212

/x/ (BY MAIL) I caused such envelope with postage thereon fully prepaid to be placed in the United States mail a Beverly Hills, California.

/__/ (PERSONAL SERVICE) I caused such envelope to be delivered by hand to the offices of the addressee.

/__/ (BY FACSIMILE) I caused such document to be transmitted by facsimile to the offices of the addressee.

I declare under penalty of perjury under the laws of the state of California that the above is true and correct and that I am employed in the office of a member of the bar of this court at whose direction the service was made.

Executed at Beverly Hills, California this 22nd day of May 1997.

/s/
JOHANA RENTERIA

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Attorneys for Defendant
RANDY SEFRIOUI

UNITED STATES DISTRICT COURT

FOR THE CENTRAL DISTRICT OF CALIFORNIA

JEANNE- PIAUBERT, S.A., a Corporation, and FRAGRANCE GROUP, LTD., a Corporation, Plaintiffs, vs. RANDY SEFRIOUI, an Individual, Does 1	Case No.: CV-97-0327 HLH REPLY IN SUPPORT OF MOTION TO DISMISS FOR TO DISMISS FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED [FRCP 9(b) AND 12(b)(6)] Date: June 9. 1997 Time: 10:00 a.m.

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I.

SUMMARY OF ARGUMENT.

Characterization of the "new business venture" (hereafter "Venture") as a "security" would break new ground and certainly extend existing law. The remedial purposes of the Securities Exchange Act of 1934 (the "Act") do not warrant such extension. Not every alleged fraud implicates the securities laws. Plaintiffs' alleged fraud does not implicate the Act.

In their opposition papers, Plaintiffs scrupulously avoid and never mention the *actual terms* of the alleged "transactions" which "formed" the Venture. They completely ignore the Shareholders Agreement (Exhibit D), Promissory Note ("Note") (Exhibit G) License Agreement (Exhibit F) and other agreements which allegedly constitute the Venture.[1] Plaintiffs avoid the real terms of the Venture because they contradict the mere legal conclusions added to the First Amended Complaint. No new "facts" are alleged - only new argument. Plaintiffs cannot plead around the essential terms of the Venture. Consequently, the securities claims should be dismissed without leave to amend.

Plaintiffs' attempt to pigeonhole aspects of the Venture into discrete categories of "security" -- such as

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[1/] All "Exhibits" mentioned herein are attached to the Motion.

"stock" or a "note" -- rests on a misdescription of the Venture. Plaintiffs issued the stock in Jeanne Piaubert, Holdings, Inc., ("Holdings"), Fragrance's Limited Partnership interest and the Note *to themselves.* After plaintiffs' creation of the Venture, they took these interests. These interests represent the manner in which plaintiffs chose to exercise ownership and control over the Venture. Moreover, this was a privately negotiated, one-on-one transaction. None of the alleged interests is by definition a "security". The Venture must be analyzed in its totality, and its economic reality examined. It should not be broken down into discrete parts to avoid the policies and purposes of the Act. The Venture fits no easy pigeon hole.

Plaintiffs cite no authority that the transactions constituting the Venture constitute a security. Indeed, they can not. The fact that none of the cases cited resemble the pled series of transactions attests to its uniqueness. Unlike any of the cases cited by plaintiffs, plaintiffs *themselves* created the Venture. They issued stock, and, a limited partnership interest to *themselves.* They took the Note from a controlled entity after creating it. These were not investment interests.

Unlike the cases cited by plaintiffs the Venture was not publicly marketed. It was never intended to be publicly marketed. No brokers were used. The stock of a

going business was not sold. For these reasons, *Landreth* is inapplicable to this case. In addition, the shares in Holdings do not bear the usual characteristics of stock. The Shareholders Agreement (Exhibit D) and Option Agreement (Exhibit E) conclusively demonstrate that the "stock" in Holdings cannot be marketed, transferred, hypothecated, pledged or encumbered contrary to plaintiffs' conclusory allegations.

The Note is not a "security" since it bears a "family resemblance" under the *Reves* case to a category of instruments which is not a "security" as a matter of law. The Note simply formalizes an open book account to fund the cash flow needs of the Venture. Application of the four-factor test prescribed by *Reves* also shows that the Note does not trigger the Act.

Not only does no security exist, but Sefrioui's activities were not "in connection with" a security. None of the alleged securities were in existence at the time Sefrioui is alleged to have misrepresented his background and experience. Because none of the alleged securities existed at the time of Sefrioui's alleged fraud, and because he was neither a seller nor profited from any sale of any alleged security, clear authority shows that the "in connection with" requirement cannot be satisfied. The alleged fraud was not in the course of any sale of, and did not touch upon, any then existing "security." For these same reasons, no causation exists as a matter of law.

An important policy behind the anti-fraud provisions of the Act, is to assure that purchasers of marketed securities are not misled by sellers who hold unique control over information

material to the investment decision. That policy concern cannot be furthered by this case. The allegations make clear that plaintiffs created the Venture. As creators and owners of the Venture, plaintiffs controlled information relevant to their decisions to issue themselves a limited partnership interest in Jeanne Piaubert Cosmetics, Ltd. ("Limited Partnership"), controlling shares in Jeanne Piaubert Holdings, Inc. (the "controlling entity" as it is defined by plaintiffs in paragraph 22 of the Original Complaint) and to make advances to the Venture under the Note.

For these reasons, the state securities claim should also be dismissed.[2]

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[2] Plaintiffs mischaracterize the court's rulings in connection with the first motion to dismiss. All securities fraud claims (state and federal) were dismissed, contrary to plaintiffs assertion. (Opposition, "Opp.", 1:24-25.) Plaintiffs repeated statements that other of plaintiffs arguments were "rejected" is also untrue. In granting the motion with respect to the securities claims, the court was silent with respect to certain of Sefrioui's arguments. Sefrioui interpreted this to mean that the court found it unnecessary to address all of the reasons offered by Seffioui to dismiss those claims. Plaintiffs claims are barred by the one-year statute of

Regardless, under state law, unlike the Act, privity is required. Sefrioui was not a seller. Privity is not alleged. Cited authority is dispositive. No contrary argument can be made by plaintiffs in good faith.

Plaintiffs knew more than one year before filing their complaint that the alleged business plan could not be achieved. Because the one year business plan was not remotely achieved after a year, plaintiffs knew it was not achievable. Knowing this, they waited more than a year to file the complaint. Plaintiffs cannot plead around specified facts contained or referenced in the pleadings demonstrating this delay.

II.

AFTER IT CREATED HOLDINGS, JPSA ISSUED ITSELF 67% OF HOLDINGS' STOCK. NEITHER THIS TRANSACTION NOR THE STOCK ITSELF IMPLICATES THE ACT.

A. Plaintiffs Rely Exclusively On The Application Of Landreth Which Does Not Apply Here.

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limitations. This is revealed by plaintiffs own pleadings and the business plans referenced in the pleadings and attached thereto.

This Court previously ruled that JPSA's shares in Holdings were not "securities". The Amended Complaint does not allege new "facts" with respect to these shares. Instead, JPSA merely pleads certain legal conclusions, verbatim, from *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 105 S. Ct. 2297, 85 L. Ed. 2d 692 (1985). *Landreth* is a very slim reed for JPSA to rest its case on. Not only does the Shareholders Agreement contradict plaintiffs conclusory allegations, as explained below, but *Landreth* simply does not apply. Therefore, this Court should again rule that the shares in Holdings do not constitute a security.

Landreth does not apply for several reasons. First and foremost, the question presented in *Landreth* – "whether the sale of all the stock of a company is a securities transaction subject to the anti-fraud provisions of the Federal Securities Laws" – is irrelevant to this case. *Id.* at 683. In *Landreth, owners of the stock of all ongoing lumber business sold their stock to a different* buyer. Holdings was not an ongoing business. Instead, it was created by the venturers, including JPSA. Moreover, Sefrioui did not sell or cause the sale of stock to JPSA. Instead, JPSA, after it formed Holdings, essentially issued shares to itself without payment.

Unlike the timber business, Holdings was engaged in no business at the time of the transactions. JPSA formed Holdings merely to hold the stock of Jeanne Piaubert

Management, Inc. ("Management").[3] Consequently, unlike the

buyers in *Landreth, JPSA* controlled Holdings at its formation and the information relevant to JPSA's decision to issue itself stock. Therefore, the issue in *Landreth* was different.

3/ Nowhere have plaintiffs alleged that Holdings conducts any business. In fact, the original Complaint refers to Holdings as "the controlling entity". (Original Complaint, ¶ 22.) In addition, the Shareholders Agreement Of Jeanne Piaubert Holdings, Inc. describes the business of Holdings as follows: "The Company [Holdings] owns all of the issued and outstanding capital stock of Jeanne Piaubert Management, Inc., a California Corporation (the "General Partner"). The General Partner is the sole general partner of Jeanne Piaubert Cosmetics, L.P., a California Limited Partnership d/b/a Jeanne Piaubert Cosmetics, Ltd. (the "Operating Company")." (Exhibit D, p. 127.) The Shareholders Agreement was entered into May 20, 1994, more than one month after Holdings was formed by plaintiffs. (Original Complaint, ¶ 17.) Definitely, the shares in Holdings could not be issued until after Holdings and Management were formed. The same time Management and Holdings were formed, Jeanne Piaubert Cosmetics, L.P. was formed by plaintiffs. (Original Complaint, ¶ 18.) By definition, Limited Partnership could not make a note until after it was formed. Consequently, each of the asserted "securities" were issued by entities created by plaintiffs.

Because the issue in *Landreth* is irrelevant to this case, so too is the holding. The Court concluded "that the stock at issue here is a 'security' within the definition of the Act, and that *the Sale of Business Doctrine does not apply." Landreth, supra,* 471 U.S. at 697. (Italics added.) Sefrioui never invoked the "Sale of Business Doctrine" defense. He did not invoke this defense because plaintiffs have not alleged the sale of a going business.

The facts of *Landreth* are also materially different in other respects. The stock in *Landreth* was "offered ... through both Washington and out-of-state brokers." *Id.* at 683. The Court found it significant that the stock was "widely offered". *Id.* at 684. By contrast, the shares in Holdings were not widely offered and no brokers were employed. For these reasons alone, *Landreth* is inapplicable to the present case.

Courts have narrowly construed *Landreth* and criticized it. For example, in *DMI Furniture, Inc. v. Brown, Craft & Company.*, 644 F. Supp. 1517 (C.D. Cal. 1986), Judge Letts stated that "the reasoning of the Supreme Court was fallacious." *Id.* at 1523. In a case much closer to *Landreth* than this case, Judge Letts refused to extend the *Landreth* decision:

> "This Court does not presume to try to educate the Supreme Court. This Court has neither the knowledge, wisdom or experience to do so.

Nothing in the foregoing analysis is intended for that purpose. On its own facts, and between the parties involved there, the *Landreth* decision may be relatively unexceptionable. On its own facts, there is no need to question or go behind the Court's reasoning. *As applied by extension to the case at bar, however, the matter is different." Id.* at 1525. (Italics added.)

Judge Letts correctly noted that "one of the primary theses upon which the Court relied in *Landreth* was its assumption that the parties to transfers of corporations between successive owners ordinarily can be expected to know that they are involved in a securities transaction." *Id.* at 1522. The court in *DMI Furniture* disagreed with this assumption. Regardless, this thesis does not hold true in the present case. It cannot be reasonably stated that when JPSA formed Holdings and took its stock, Sefrioui could be ordinarily expected to know that his involvement implicated the Federal Securities Laws.

Judge Letts warned against any extension of the *Landreth* decision for another reason. In a well-reasoned analysis, he notes that an "investment" ordinarily means "a segregation of assets to be turned over to another with the risk of gain or loss with respect to those assets committed to the managerial responsibility of such other person." *Id.* at 1523. "[I]nvestment 'securities' in whatever form represent the 'bundle of rights' which an investor receives *back* by contract from the person to whom he grants the

managerial responsibility for his invested assets." *Id.* at 1523. To constitute an investment, this "bundle of rights" must be separate from the assets which are managed by others. When the "bundle of rights" merges with control over the assets, there exists no independent obligor against which to assert the "bundle of rights." *Id.* at 1524. "They merge and are extinguished." *Id.* at 1524. In such a situation, no security exists because there is no true "investment".

By Judge Letts' analysis, JPSA's stock in Holdings cannot be deemed a security. JPSA concededly formed and controlled Holdings. Since JPSA was an owner and manager of Holdings when the stock was issued, the legal rights represented by the stock merged with that ownership and were "extinguished". The entire time JPSA owned stock in Holdings, it controlled Holdings. It was, therefore, not a true investment and should not be deemed a security.

1. <u>Although Landreth does not apply, JPSA's shares do not bear the ordinary characteristics of stock.</u>

In sum, the issue, holding, theses, facts, and policy arguments underpinning *Landreth* are inapplicable to, and different from, this case.

Even if *Landreth* did apply, the *Landreth* Court itself stated that "the fact that instruments bear the label 'stock' is

not of itself sufficient to invoke the coverage of the coverage of the Act." *Landreth,* supra, 471 U.S. at 686. Even in the sale of a business case, the stock must bear the "usual Characteristics" that an ordinary purchaser associates with stock. The Court noted that among those usual characteristics are "negotiability" and "the ability to be pledged or hypothecated." These usual characteristics are absent here.

Contrary to the conclusory allegations of the complaint, the Shareholders Agreement (Exhibit D) and Option Agreement (Exhibit E, pp.152-3) prohibit free negotiability of the stock. As discussed in the Motion, plaintiffs' conclusory allegations are insufficient. *SEC v. Seaboard Corp.*, 677 F.2d 1315, 1316 (9th Cir. 1982). The Court need not accept unreasonable inferences or unwarranted deductions of fact. *Western Mining Counsel v. Watt,* 643 F.2d 618, 624 (9th Cir. 1981). On a motion to dismiss pursuant to Rule 12(b)(6), "courts will examine whether conclusory allegations follow from the descriptions of facts as alleged by plaintiff ." *Brian Clewer, Inc.. v. Pan American World Airways, Inc.*, 674 F.Supp. 782, 785 (C.D. Cal. 1986). Moreover, where documents are attached to a complaint and incorporated by reference, and those documents contradict allegations in the complaint, the Court may disregard those allegations. *Durning v. First Boston Corp.*, 815 F.2d 1265 (9th Cir. 1987). Plaintiffs do not contest these principles, nor can they.

Consequently, when plaintiffs conclusorily pled that the shares in Holdings bear the usual characteristics of "stock", such allegations should be ignored since the Shareholders Agreement (Exhibit D) and Option Agreement show otherwise. The Shareholders Agreement states: "In order to provide for the stability of the Company and to promote continuity of its management and policies, the Shareholders desire ... to restrict the

manner and means by which the Shares may be sold, assigned or otherwise transferred." (Exhibit D, p. 127.) The Shareholders Agreement also specifically prohibits the stock from being pledged, hypothecated or encumbered.[4] Similarly, a stock legend incorporates these

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[4] Paragraph 7. 1. 1. (Restriction On Shares) states: ***"None of the Shares*** now or hereafter owned or held by any of the Shareholders or their successors and assigns, nor any voting trust certificates issued in respect of such Shares, ***may be sold, assigned, transferred, pledged, hypothecated, or in any other way disposed of or encumbered, voluntarily or involuntarily,*** accept in accordance with the terms of this Agreement. ***No sale, transfer or other disposition of Shares shall be valid,*** effective, entitled to recognition for any purpose, including voting or dividend rights, or made on the books of the Company, if made in violation of the provisions of this Agreement. ***No shares may be voluntarily encumbered*** or subjected to a lien or security interest of any kind by any Shareholder and any such encumbrance, lien or security interest shall be null and void and of no force and effect, except as provided in this Agreement." Only a limited exception applies to

restrictions. (Exhibit E, p. 153.) Because the shares in Holdings do not possess the usual characteristics of "stock", even under the inapplicable *Landreth* test, they are not "securities". Consequently, the *Howey* test applies. *Id.* at 687-689. This Court has already ruled that plaintiffs' allegations flunk the *Howey* test.

B. Contrary To Plaintiffs' Assertions, Not All Transactions Involving Stock Automatically Qualify As Securities.

Transactions which involve stock do not necessarily qualify as "securities", under 15 U. S.C. § 78 c(a)(10), for purpose of imposing Section 10(b) liability. *Landreth* itself makes this clear, *Anchor-Darling Industries, Inc. v. Suozzo,* 5 0 F.Supp. 657, 662-664 (E.D. Pa. 198 1) (Purchaser of stock from three corporations did not involve a "security transaction".) For reasons explained in Sefrioui's Motion, plaintiffs controlled the Venture and were not dependent on Sefrioui. Therefore, plaintiffs cannot evade an examination of the substance of the transaction.

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transfers to "family trusts established for the benefit of a Shareholder and/or his or her spouse and/or lineal descendants provided, and only for so long as, such Shareholder retains the sole voting control over the shares..." (Exhibit D., pp. 13 1-132.)

A factor explained by the *Anchor-Darling* court Is applicable here – since neither case "involve[s] a sale of corporate stock to raise capital for profit making purposes." *Id.* at 665. JPSA took shares in Holdings, which JPSA helped create, to acquire control over the Venture, not to raise capital. (Original Complaint, ¶ 23.) The essence of plaintiffs' allegations is that plaintiffs formed the Venture with the Hollisters and Sefrioui. After asserting control over the Venture (through the creation of Holdings "the controlling entity"), plaintiffs *issued themselves* stock and a limited partnership interest. (Original Complaint, ¶¶ 17 and 23.) As explained below, the substance of this transaction does not implicate the securities laws.

C. **JPSA Concedes It Paid Nothing For Its Stock In Holdings.**

Once again, plaintiffs incorrectly assert that the term "security" does not require payment. In this case, not only ",as their (sic) no payment, but no consideration is alleged. In a strained attempt to create some consideration, they point to the allegation that $120,000 in startup funding was given along with later funding. However, this "funding" has nothing whatever to do with payment for the stock.

Plaintiffs contradict themselves since they assert that this funding was given in connection with the Note, not the stock. The Note itself refers to the $120, 000 as a "bridge loan". (Exhibit G, p. 208.) The Shareholders Agreement also makes clear that the funding given was pursuant to the

terms of the Promissory Note. (Exhibit D, ¶¶ 127 and 131.) No "purchase" has been or can be alleged.

Although there was no "purchase" at all in connection with the stock, it is clear from the allegations of both complaints and the exhibits that the object of any alleged investment was not Holdings. Plaintiffs improperly divorce the "purchase" from the alleged object of the investment. The actual alleged object of plaintiffs supposed "purchase" was the "establishment of the United States franchising business." (Original Complaint, ¶¶ 18, 19, 20, 21 and 23; kept a Amendment Complaint, ¶¶ 16, 17, 18, 19, 20 and 21.) Holdings was not the alleged investment object. What plaintiffs bought was a controlling stake in the Venture securities...," This "touch"

requirement, as noted in *Chemical Bank v. Arthur Anderson & Company.*, 726 F.2d 930, 943 (2d Cir. 1984), is a variation of the "in connection with" language.

Whether phrased as the "touch" requirement or the "in connection with" requirement, one fact remains -- Sefrioui's alleged misrepresentations in this case do not "touch" and are not "in connection with" any sale or purchase of securities. In this case, plaintiffs allege that Sefrioui "made several representations to [them] regarding (his) background, experience, prior business

responsibilities, professional accomplishments, and forecasts concerning the number of stores [he] could and would open in the first year of operation of a new United States franchising business for Jeanne Piaubert Cosmetics." (Amended Complaint, ¶ 11.) These alleged misrepresentations did not "touch" any alleged security. According to plaintiffs alleged timeline, the alleged "securities" did not exist at the time of the alleged misrepresentations. Sefrioui's alleged misrepresentations could not be "in connection with" non-existent instruments.

By no stretch of the imagination could Sefrioui's alleged misrepresentations relate to any sale or purchase of securities which did not exist. He was never a "seller" of securities. He did not offer to sell stock to anyone and, as a matter of fact, Sefrioui did not benefit from any sale of stock. No contrary allegations are made. Furthermore, Sefrioui's alleged misrepresentations were never calculated to influence the investing public. He did not misrepresent the quality of the stock or the Note. All the alleged statements were directed to plaintiffs before the Venture was formed and before any stock, partnership interest or Note were made. Therefore, they did not contemplate plaintiffs' alleged "securities", much less induce plaintiffs' alleged "purchase" of them.

III.

FRAGRANCE'S LIMITED PARTNERSHIP INTEREST, IN THE CONTEXT OF THE VENTURE, DOES NOT INVOKE THE ACT.

Plaintiffs completely ignore their admissions in documents and in the pleadings which clearly demonstrate plaintiffs' control over the Venture and over the limited partnership in particular. Plaintiffs contend that they did not have the ability to control the operations of the limited partnership because they have alleged that "they did not have the ability to control the operations of the limited partnership." Plaintiffs merely plead a legal conclusion which this court has already rejected.

A. Contrary To Plaintiffs' Assertion, An Interest Labeled A Limited Partnership Interest Is Not By Definition A Security.

Plaintiffs also falsely assert that a limited partnership interest "by definition" a security. (Opp., 4:12-14.) This is plainly untrue. See, BAMCO 18 v. Reeves, 675 F Supp, 826 (S.D.N.Y. 1987) (complaint dismissed pursuant to FRCP 12(b)(6) where one-on-one negotiations resulted in at best two limited partnership interests). 15 U.S.C. § 78(c)(10) does not include a limited partnership interest within the definition of a "security." Only if a limited partnership qualifies as an "investment contract" will it be deemed a "security." An "[a]nalysis of whether a limited partnership interest constitutes a security begins with determining whether this interest is, in effect, an

investment contract." *BAMCO 18*, 675 F.2d at 830 (analyzing limited partnership interest under *Howey* definition of an investment contract).

The point of the foregoing discussion is that plaintiffs cannot dismiss as irrelevant the *Williamson* control analysis of the *Howey* test. Plaintiffs characterize this analysis as "irrelevant" because, as the court has already held, the Venture fails that analysis.

Plaintiffs employ a syllogistic argument which is nonsensical. Plaintiffs start with the false proposition that by labeling the interest a limited partnership, "under California law", "Plaintiff, as a limited partner, did not have the ability to control the operations of the limited partnership." (Amended Complaint, ¶ 17; Opp., 13:21-24.) by employing this definitional game,

plaintiffs sidestep and completely ignore the applicable *Howey* and *Williamson* tests. The syllogism breaks downs, because, of course, *the fact* alleged clearly demonstrate pervasive control by plaintiffs over the Venture and the Limited Partnership. The Amended Complaint does not even attempt to allege new facts which might overcome the demonstration of their own control. Instead, plaintiffs merely allege passages from cases and legal conclusions in the Amended Complaint.

Plaintiffs are understandably bashful about the Exhibits attached to the Motion. In the License Agreement (Exhibit F), plaintiffs admit their control over the limited partnership: **"WHEREAS, Bogart owns and controls IJP, JP[SA] and Fragrance and indirectly controls the Licensee [limited partnership]."** (Exhibit F, p. 164.) Bogart's control over Limited Partnership is indirect through JPSA and Fragrance. Plaintiffs completely ignore this binding and conclusive admission.

Having plead the existence of documents which expressly state control over the Limited Partnership, plaintiffs cannot overcome this admission by conclusorily pleading no control. Where documents attached to or referenced in a complaint contradict allegations in the complaint, the court should disregard those allegations. *Durning v. First Boston Corp.*, 1815 F.2d. 1265 (9th Cir. 1987).

IV.

PLAINTIFFS FAIL TO REBUT THE WIDELY ADOPTED RULE THAT PRIVATELY NEGOTIATED ONE-ON-ONE TRANSACTIONS DO NOT IMPLICATE THE SECURITIES LAWS.

Plaintiffs also sidestep the wealth of clear authority that a privately negotiated, one-on-one transaction, like the "new business venture," is not a security and is not intended to implicate the securities laws. Plaintiffs simply conclude that this authority is irrelevant since a security is

alleged. However, the cases cited in the Motion, *Mace, Marine Bank BAMCO 18, In Re National Mortgage and Tab Partnership* state a rule designed to determine whether a security exists in the first instance. Plaintiffs concede that the Venture was privately negotiated one-on-one.

They must also concede that this is not a sale of a business case under *Landreth.* Therefore, by definition, no security exists. Not every fraudulent scheme concocted to take advantage of investors is proscribed by Section 10(b) and Rule 10b-5, "but only those fraudulent schemes that are employed 'in connection with the purchase or sale of any security.'" *Herpich v.. Wallace,* 430 F.2d 792, 805-806, (9th Cir.1970).

Plaintiffs conceded in their Opposition to the first Motion to Dismiss that this was an entirely privately negotiated one-on-one transaction. (Original Opp., 3:6-7; 4:2-3.) They do not quarrel with that admission now. (Opp. 3:19-21.): 19-2 1.) No aspect of the alleged Venture was publicly offered. The "new: business venture" was structured by plaintiffs to meet their needs and to assure them control. Sefrioui and the Hollisters pitched an idea to Jacques Konckier, the President of JPSA and its parent Jacques Bogart S.A. An acceptable business plan was jointly developed. Entities were formed and agreements

drawn which handed control over the Venture to JPSA which funded it. Such a transaction does not implicate Section 10(b). Plaintiffs cite not a single case which suggests that the Venture is an "investment contract" or a security.

V.

JPSA CREATED, CONTROLLED AND FUNDED THE VENTURE. WHEN JEANNE PIAUBERT COSMETICS, THE LIMITED PARTNERSHIP, MADE A NOTE TO JPSA, IN EFFECT, JPSA ISSUED ITSELF THE NOTE. THIS CANNOT IMPLICATE THE FEDERAL SECURITIES LAWS.

Recognizing that neither the alleged stock nor the alleged limited partnership interest are true securities, plaintiffs drudge up the Note and attempt to characterize it as a security. While plaintiffs initially pled the existence of the Note, they did not attempt to characterize it as a security – for good reason.

A. **The Note Formalizes An Open Account Debt And Is, Therefore, Not A Security Under *Reves*.**

Plaintiffs rely exclusively on *Reves v. Ernst & Young*, 494 U.S. 56, 110 S.Ct. 945, 108 L.P.Ed.2d 47 (1990). For reasons described in the Motion and as more fully set forth

below, *Reves* does not support JPSA's contention that the Note is a "security" under the Act. In *Reves,* the Court stated that "Congress was concerned with regulating the investment market, not with creating a federal cause of action for fraud." *Id.* at 65. The Court adopted the "family resemblance test". The Court identified several categories of instruments, which had been the subject of prior cases, which it agreed were clearly not securities. One such category of instrument which the court concluded was not a security is "a note which simply formalizes an open account debt incurred in the ordinary course of business". *Id.* at 65. The Note and Shareholders Agreement, as discussed below, conclusively demonstrate that the Note "merely formalizes an open book account." The Court stated, "If the note is exchanged... to correct for the seller's cash-flow difficulties... the note is less sensibly described as a 'security'." *Id.* at 66.

JPSA alleges that it "transferred $5,000,000 to the Limited Partnership and in return received a promissory note." (Amended Complaint, ¶ 18.) By this, JPSA insinuates that the loan was in a "lump sum." JPSA also incorporates the language of the *Reves* case by stating that the note was not one "which simply formalized an open-account debt incurred in the ordinary course of business" and by alleging that "JPSA was interested primarily in the profit the Note was expected to generate." (Amended Complaint, ¶ 18.) However, these legal conclusions are

directly contradicted by the very terms of the agreements identified by plaintiffs.

The Note was not in a lump sum and it does "simply formalize an open-account debt" to meet the cash-flow needs of the Venture. In the Shareholders Agreement, executed by Konckier on behalf of JPSA, the note is described as follows:

> "The Strategic Shareholder [JPSA] shall make loan(s) in monthly installments as set forth on the *cash flow* statement attached hereto as Schedule H. The Capital Note has been structured in the form of a revolving loan (rather than a lump sum loan) (i) so that the Strategic Shareholder need not fund amounts to the Operating Company prior to the time that the ***capital is actually needed*** by the Operating Company, and (ii) ***to avoid interest charges*** on capital note financings. . ." (Exhibit D, p. 131.) (Emphasis added.)

Not only does the Shareholders Agreement contradict JPSA's allegations, so too does the Note. Pursuant to the Note, the Limited Partnership agreed to repay "the aggregate unpaid principal *amount of advances* hereunder as shown either on the *schedule* attached hereto (and any continuation thereof) or in the *records of Lender.*"

(Exhibit G, p. 206.) (Italics added.) The "advances" noted on the "schedule" and in the "records" of JPSA define an open account to assist with "cash flow" when "actually needed." The Note also states, "The failure of the holder of this note to make (or any error in the making of) a notation of any payment made on this Note shall not (i) limit or otherwise affect the obligation of maker hereunder with respect to payments of principal or interest under this note or (ii) subject the holder hereof to any liability whatsoever." (Exhibit G, p. 207.) According to the Note itself, as JPSA made advances, it had the fight, but not the obligation to, record the advances on an attached schedule. This underscores the fact that the schedule attached to the Note is an open account and the Note only formalizes that open account. That schedule, reflecting only the first advance, is attached to the Note. (Exhibit G, p. 208.)

JPSA directly contradicts its own allegations. Therefore, the court should reject the false and conclusory allegations of the Amended Complaint. The *Reves* decision clearly states, and JPSA concedes, that "a note which simply formalizes an open-account debt incurred in the ordinary course of business" is not a "security." *Id.* at 66. Despite plaintiffs attempt to distinguish *Varnberg v. Minnick,* 760 F.Supp 315 (S.D.N.Y. 1991) it should control. This should end the analysis.

B. Reves' Four-Factor Test Demonstrates That The Note Is Not A Security.

In analyzing what separated notes which were not securities from notes which were securities, the court adopted a four-part test. Plaintiffs completely ignore that four-factor test. Application of that test also makes clear that the Note herein does not implicate the Act. Implicit in the test is that the making of the note is an arms-length transaction. The categories of instruments and factors to be applied, identified by the *Reves* Court, do not contemplate the situation here where JPSA created the Venture and issued *itself* a note.

The first factor identified by the Court was to "examine the transaction to assess the motivations that would prompt a reasonable seller and buyer to enter into it." *Id.* at 66. Unlike the *Reves* case, where no notes were sold to at least 1,600 farming Company-op members, as well as non Company-op members, and which were mass marketed as an "Investment Program", the Note given to JPSA did not involve any buyer or seller. Instead it was a mechanism for funding the cash flow needs of the Venture until it became self sustaining.

The remaining factors identified by the *Reves* court also make clear that the Note is not a security. The second *Reves* factor requires examination of the "plan of distribution" of the instrument to determine whether it is an instrument in which there is common trading for speculation or investment." *Id.* at 66. (Citations omitted.)

Once again, the Note is not intended and was not commonly traded for speculation or investment and has no plan of distribution. This militates against finding it a "security."

The third factor identified by the *Reves* court also militates against it characterization as a "security". "Third, we examine the reasonable expectations of the investing public: The Court will consider instruments to be I securities' on the basis of such public expectations . . ." *Id.* at 66. Just as the "reasonable expectations of the investing public" would not consider JPSA's issuance of shares in Holdings to itself as implicating

Sefrioui in federal securities laws, neither would a reasonable investor consider that JPSA's Note, in effect to itself, implicates Sefrioui under the federal securities laws,.[5]

5/ In addition to the Shareholders Agreement and the Note, JPSA entered into an Option Agreement (Exhibit E) and a License Agreement. (Exhibit F.) Under the Option Agreement, on the "Recoupment Date" (defined as repayment of the Note), the minority shareholders would have the option to purchase a controlling interest in Holdings. (Exhibit E, pp. 150-151.) In other words, JPSA would retain control until the Note was repaid. All stock issued to JPSA was subject a stock legend set out in the Option Agreement prohibiting the transfer, sale, assignment, pledge, hypothecation, or

The Note also contradicts plaintiffs allegations in another material respect. JPSA conclusorily alleges that it "was interested primarily in the profit the Note was expected to generate." However, quite the opposite is true. The only profit that could be derived from the Note was the interest. However, JPSA acted to reduce the amount of that interest according the Shareholders Agreement – advances would be made only as "actually needed ... to avoid interest charges." (Exhibit D, p. 131.) This court should reject the duplicitous conclusory allegations of the Amended Complaint since they are contradicted by documents executed by plaintiffs and referenced in their pleadings.[6]

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encumbrance of JPSA's shares. (Exhibit E, p. 153.) Proceeds from the Note would be used to pay JPSA and its affiliates, Bogart and Fragrance. The Limited Partnership would take the advances made by JPSA and use them, in part, to pay for the products distributed through Venture by JPSA. (See Exhibit F.)

6/ The fourth factor does not seem to apply. Garden variety advances by a parent to a controlled affiliate to meet its start-up cash flow needs is not the subject of any regulatory scheme designed to reduce the risk of the instrument. However, existing laws do permit recovery for breach of an open book account and account stated. Statutes also provide for recovery of attorneys' fees on such claims. (Calif Civ. C. § 1717.5.)

The *Reves* decision supports Sefrioui, not JPSA. The Note cannot be reasonably construed as a "security". The belated insertion of the Note as a "security" by JPSA should be rejected. Since neither the Note, Limited Partnership interest nor the shares in Holdings constitute securities, the first, second and third claims for relief as to JPSA, must be dismissed.

VI.
THE THIRD CLAIM FOR RELIEF UNDER THE CALIFORNIA CORPORATIONS CODE MUST BE DISMISSED.

In addition to those reasons set forth above, Sefrioui cannot be liable under California Corporations Code Section 25504.1 because Sefrioui was not himself a seller. Holdings, created and controlled by JPSA issued its stock to JPSA. The Shareholders Agreement (Exhibit D) and the Option Agreement (Exhibit E) demonstrate that Sefrioui never owned much less sold the alleged stock or any other alleged security to plaintiffs.

Plaintiffs fail to discuss or rebut controlling authority which directly contradicts plaintiffs' assertion that Sefrioui need not be a seller to be liable under the California Corporations Code.

> "Sections 25504.1 and 25504.2 create liability *for those who assist* in the violation of section 2540). A violation of section 25401 requires privity between the seller of a secured instrument and a purchaser. It is *limited to actual sellers.* Thus, 'because the causes of action provided for in sections. . . 25504.1 and 25504.2 are by their terms derived from section 25401, *a failure to show, strict privity will defeat these derivative claims."* [Citations omitted.] (Italics added.)

Empl. Ins. Of Wausau v. Musick, Peeler & Garrett, 871 F.Supp. 381, 387 (S.D. Cal. 1994).

The *Empl. Ins. Of Wausau* case is dispositive. It confronted the identical claim that a defendant "materially assisted" in a sale. The court clearly ruled, as have other courts, that "strict privity" is still required. Sefrioui did not *sell* stock in Holdings to JPSA. Sefrioui did not *sell* any limited partnership interest to Fragrance. Sefrioui did not make the Note. No contrary allegations exist or can be made. Finally, plaintiffs did not buy a stake in the Venture from Sefrioui. No privity exists. Therefore, the California securities fraud claim must be dismissed for this additional reason.

SPECIFIC ALLEGATIONS IN THE COMPLAINT SHOW PLAINTIFFS WAITED MORE THAN ONE YEAR TO ASSERT A SECTION 10(B) CLAIM AFTER LEARNING OF THE ALLEGED FRAUD.

Plaintiffs cannot dispute their own alleged timeline set forth in their Complaints. They do not quarrel with that timeline as presented in the moving papers. Instead, plaintiffs suggest that complaints should not be dismissed on motion because statute of limitations defenses are subject to "alternate interpretations." However, no alternate interpretation can be reasonably made from plaintiffs allegations. Plaintiffs rely on a conclusory allegation in paragraph 29 of the Amended Complaint to contradict their own specific allegations. This is impermissible. *Brian Clewer, Inc. v. Pan* American W*orld Airways, Inc.* 674 F.Supp. 782, 785 (C.D. Cal. 1986).

Business Plan No. 3 was submitted in March or April, 1994 as a one year plan. (Amended Complaint, ¶¶ 15.) The Venture was formed and "start-up" took place in May, 1994. (Amended Complaint, ¶¶ 19-21.) Plaintiffs allege that Business Plan No. 3's projected number of franchise openings – 120 in one year -- was unrealistic. (Amended Complaint, ¶ 15.) Plaintiffs allege that since Sefrioui opined that the plan was realistic, this constitutes fraud. Plaintiffs further allege that by the end of the first year under the plan, only one "company store" and one "franchised store" (of a projected 120) had been opened.

(Original Complaint, ¶ 23.) Therefore, plaintiffs knew before, and certainly no later than May, 1995, that the plan was not remotely realistic. The complaint was not filed until January, 1997. These facts discernable from the complaints and the Business Plan contradict plaintiffs' general allegation that within a year of filing the Complaint they discovered that these projections were unrealistic.

Plaintiffs contend that notwithstanding their specific allegations, they only discovered Defendant's *scienter* within a year of filing of this action. As usual, plaintiffs offer no authority to support the proposition that discovery of a defendant's "scienter" tolls the statute of limitations. To the contrary, courts have specifically held that discovery of scienter "cannot be used

as basis for emasculating the statute of limitations." *Ohio v. Peterson Lowry, Rall, etc.*, 651 F.2d 687, 695 (10th Cir. 1981); *Chase Manhattan Bank, N.A. v. T&N PLC*, 905 F.Supp. 107 (S.D.N.Y. 1995) (discovery of scienter unnecessary "to begin statute of limitations for fraud.") This authority is controlling here.

Plaintiffs' contention that it is improper to decide as a matter of law that plaintiffs' complaint is time barred has also been rejected. "Any rule which makes the statute of limitations necessarily a jury question defeats the statute's

purpose of preventing trials of stale claims." *Ohio v.* Peterson, *Lowry. Ralls, etc.*, 651 F.2d at 694.

VIII.
THERE CAN BE NO CAUSATION WHEN NO SECURITY EXISTS AT THE TIME OF THE ALLEGED MISREPRESENTATION.

As described more fully below with respect to plaintiffs failure to satisfy the "in connection with" requirement, when Sefrioui allegedly mis-described his background and the "achievability" of the "March or April 1994" Business Plan (Amended Complaint, ¶ 15), the Venture had not been formed. Therefore, plaintiffs did not "purchase" the alleged "securities" on the basis of the alleged misrepresentations. At best, plaintiffs allege they formed the Venture in reliance on the alleged misrepresentations. Consequently, there is no loss causation (or for that matter transactional causation) as a matter of law. *Huddleston v. Herman & MacLean,* 640 F.2d 534 (5th Cir. 1982).

IX.
CONCLUSION.

For the foregoing reasons, and for the reasons set out in the motion and the exhibits attached thereto, the first three claims for relief in the Amended Complaint should be dismissed. Leave to amend should not be granted.

Admissions made by plaintiffs in their pleadings and their documents referenced in their pleadings and attached thereto, conclusively demonstrate that plaintiffs claims of fraud do not implicate the securities laws.

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Moreover, dismissal of the federal securities claims eliminates any federal question jurisdiction. Consequently, and for the reasons set forth in the Motion To Stay filed concurrently herewith, the remaining claims for relief should be stayed pending completion of the companion state court action.

Dated: June 2, 1997

Respectfully Submitted,

/s/ Robert G. Campbell

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PROOF OF SERVICE BY MAIL

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action; my business address is: 333 South Grand Avenue, Suite 3400, Los Angeles, California 90071.

I am readily familiar with this firm's practice for collection and processing of correspondence for mailing with the United States Postal Service. In the ordinary course of business, such correspondence is deposited, postage prepaid, on the same day with the United States Postal Service.

On **June 2, 1997,** I served the within **REPLY IN SUPPORT OF MOTION TO DISMISS FOR FAILURE TO STATE A CLAIM UPON WHICH RELIEF CAN BE GRANTED [FRCP 9(b) AND 12(b)(6)]** on the interested parties in this action by placing for deposit in the United States Postal Service at 333 South Grand Avenue, Los Angeles, California true and correct copy thereof addressed as follows:

Gregory A. Yates
Law Offices of Gregory A. Yates
9454 Wilshire Blvd., Suite 850
Beverly Hills, California 90212

The envelope(s) were sealed and placed for collection and mailing on that date following ordinary business practices.

I declare under penalty of perjury that the foregoing is true and correct. Executed on **June 2,** 1997, at Los Angeles, California.

Cynthia Bishara	/s/ Cynthia Bishara
Print Name	Signature